Part A.

**SECRET**

(Circulate under cover and notify REGISTRY of movement)

Begins: 25/3/82
Ends: 22/9/82.

PO -CH /GH/0026

PART A

PO -CH /GH/0026
PART A

Chancellor's (Howe) Papers:

WORLD ECONOMIC TRENDS AND THE 1983 BUDGET

Disposal Directions: 25 Years

[signature]
24/7/95.

12

Chairman:
Mr. A. R. M. TOFT

Vice-Chairmen:
Mrs. E. BIBBY
~~Cllr. T. P. S. CHRISTOPHER~~

Hon. Treasurer:
Mr. J. S. BROWN

Hon. Deputy Treasurer:
Mr. W. J. ROOK

C.P.C. Officer:
Mrs. E. PARKER

# Whitehaven Constituency Conservative Association

Comprising Copeland Borough Council

President: Mr. R. G. GRICE, C.B.E.

82 LOWTHER STREET,
WHITEHAVEN,
CUMBRIA.
CA28 7RF.

Tel.: Whitehaven 2513.

PPS
CST
EST
MSTL
SIR D. WASS
MR RYRIE
MR MIDDLETON
MR BATTISHILL
MR ROBSON
MR F. MARTIN
MR FRENCH

2nd March, 1982.

cc CH/EX

CH/EXCHEQUER
REC. - 4 MAR 1982
ACTION

The Rt. Hon. Sir Geoffrey Howe, QC., MP.,
House of Commons,
Westminster,
London. S.W.1.

Dear Sir Geoffrey,

I have been asked to write to you by my Executive Council.

We are concerned about the high unemployment figures in West Cumbria. We hope that when you produce your Budget you will do what you can to stimulate industry.

We are not asking for a U-turn, but will welcome any assistance you can give.

Yours sincerely,

A.R.M. Toft

A.R.M. Toft,
Chairman.

From: Rt Hon Michael Jopling MP

PWP

Government Chief Whip
12 Downing Street, London SW1

? ~~copy~~ discuss at prayers.

No need?
No such proposal?

Private & Confidential

4 March 1982

Dear Geoffrey

I understand that at the Party's Sport and Recreation Committee last night, a Mr Lawson of the Council for Physical Recreation talked about the damage which may be caused to sports clubs (not to mention Conservative clubs) in the event of an ad valorem tax on fruit machines being introduced.

Whilst, of course, I have no idea what you have in mind, I thought you might like to be warned that the CPR intend to mount a large campaign directed at those of marginal seats if it should happen. Not surprisingly, Nicholas Winterton, who was one of the three Members present, said that he would strongly oppose such a proposal. He foreshadowed that this step would unite the clubs and the pubs and give rise to a lot of trouble.

Yours
Michael

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury
Parliament Street
London SW1P 3AG

Republic of Senegal
Ministry for Economic
and Financial Affairs

The Minister for Economic
and Financial Affairs

Dakar, 25 March 1982

No 700/MEF/CAB 2
CONFIDENTIAL

Dear Minister and Friend,

The African Governors on the Board of Governors of the World Bank and the International Monetary Fund met in Dakar from 1 to 3 March 1982 to consider the World Bank report on "The accelerated development of Africa south of the Sahara - indicative action programme".*

At the conclusion of the meeting they adopted a memorandum containing observations on the proposals and recommendations made by the World Bank.

In particular they launched an appeal to the international financial community, inviting donor countries to honour in full the commitments entered into as part of the 6th ~~Reconstitution~~ Replenishment of the IDA.

In their view that appeal is of fundamental importance in that domestic efforts alone will not be sufficient to accelerate the development of Africa.

Mr Geoffrey Howe.
Chancellor of the Exchequer,
11 Downing Street
LONDON

---

* Translator's note: my translation

These efforts must be supplemented by an appreciable increase in the transfer of resources for development.

The African group on the Board of Governors of the World Bank and the International Monetary Fund has commissioned me to draw your personal attention and that of the British Government to your country's role and responsibility in the ~~reconstitution~~ replenishment of the IDA's resources.

With that in mind, I attach paragraph 8 of the African group's memorandum on the ~~Reconstitution~~ Replenishment of the Resources of the International Development Association, in which the African Governors express their profound regret at the reduction in credits for the 1982 financial year.

Complimentary close

sgd Ousmane Seck

MEMORANDUM OF THE AFRICAN CAUCUS OF
THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND
ON THE WORLD BANK'S REPORT ENTITLED
ACCELERATED DEVELOPMENT IN SUB-SAHARAN AFRICA:
AN AGENDA FOR ACTION

1. The African Governors of the World Bank and the International Monetary Fund met in Dakar from March 1-3, 1982, under the chairmanship of His Excellency Ousmane Seck, Minister of Economy and Finance of Senegal and Chairman of the African Caucus, with a view to examining the conclusions of the Report of the World Bank on Accelerated Development in Sub-Saharan Africa.

On this occasion, after thanking the World Bank for providing a good technical basis for discussions, they exchanged views on African development problems and in particular, on the plight of the Sub-Saharan countries, subject matter of the said Report.

This Report in its positive technical aspects represents a valuable contribution to the implementation of the "Lagos Plan of Action" during the 1980's.

2. The African Governors view with great concern the worsening of the world economic crisis, the effects of which are being felt more keenly in the developing countries,

especially those of Africa.

They find that the recovery measures taken thus far by the industrialized countries have further aggravated the already difficult situation of the developing countries.

These measures have caused an unprecendented rise in interest rates, instability of exchange rates, increased recourse to protectionism, a slowdown in international trade and a reduction in real terms in the transfer of official resources for development.

These actions make the entire burden of adjustment process fall on the developing nations, thus imposing further constraints on their development efforts.

The African countries are particularly vulnerable to the effects of these policies.

3. The African Governors note that economic growth in Africa was disappointing in the 1970's, and that the outlook for the 1980's is grim.

The fact is that in 19 countries, per capita incomes have risen by less than 1% a year during the 1970's and even fell in 18 other countries of the Sub-Region.

This poor economic performance is due to a multiplicity of causes, both internal and external.

Some internal factors are beyond the control of African countries. They include the after effects of

colonisation; the vagaries of the weather and natural disasters.

Furthermore, the efforts made by some African countries for their economic development did not have the expected results.

However, it must be acknowledged that external constraints have weighed more heavily on the African economies.

A series of external factors have had an adverse impact on the growth of African economies:-

- the worsening of the world economic situation,
- the deterioration of the terms of trade,
- the stagnation of exports,
- the fluctuations of commodity prices,
- widespread inflation.

As a result, the African countries are faced with a severe balance of payments crisis.

For the region as a whole the current account deficit rose from US$ 1.5 billion in 1970 to US$ 13 billion in 1981.

External debt increased from US$ 6 billion to US$ 38 billion between 1970 and 1980.

[illegible]

[illegible]

[illegible] it must be [illegible]

[illegible]

- the [illegible] of the [illegible],
- the deterioration of the terms of trade,
- the [illegible] of exports,
- the fluctuations of [illegible],
- [illegible].

[illegible]

4. The African Governors consider that, in order to cope with this situation, a new impetus must be given to the development of the Continent. To this end, it is necessary to complement the domestic efforts to be undertaken by Africans and by an increase in the transfer of official resources for development.

In this connection, African Governors fully recognize that it is necessary to make efficient use of available resources, be they human or financial, public or private.

The African Governors affirm the need for adjustment and for a constant readaptation of development policies.

However, they wish to emphasize that adjustment and readaptation of policies are the responsibility of each sovereign country. Each country will act according to its own characteristics and its political and economic options.

In this connection, Africans are determined in cooperation with the international community, to take the necessary steps to curb the deterioration of African economies and ensure a steady acceleration of growth in the Continent.

5. These efforts should apply, in particular, to the leading sectors of the economy, namely, agriculture,

industry and energy.

In agriculture, export crop production has not increased for the last 20 years. Worse still, food production has declined during the same period, thus giving rise to an intolerable food dependency.

The primary importance attached particularly to food crops reflects the objective of food self-sufficiency adopted by the highest authorities of the Continent in the Lagos Plan of Action.

In this context, special emphasis should be placed on food security and the modernisation of African agriculture.

This higher priority for agriculture in the development of Africa meets a twofold objective of equity and efficiency.

Equity because the great majority of Africans live in rural areas and any true economic and social progress in Africa must aim first at improving their lot.

Efficiency because the growth of the African nations depends heavily on the expansion of agricultural output. Furthermore, it is essential to take appropriate action so that Africa can promote and step up its exports of agricultural products so as to recover the ground it has lost.

Finally, greater access to external markets for agricultural products at remunerative and stable prices industry and agriculture.

In agriculture, [illegible] have been not [illegible] increased for the [illegible] thus giving rise to an increasing food [illegible].

The priority [illegible] food self-sufficiency [illegible] adopted by the [illegible] Lagos Plan of Action.

In this context, agriculture should be given [illegible] and [illegible] agriculture.

This high priority [illegible] development of Africa [illegible] self-reliance.

[illegible]

[illegible]

is an essential factor in revitalizing African agriculture.

6. The African Governors consider it essential to increase substantially investment in the energy sector to develop the tremendous energy potential of the region.

They fully support the expansion of World Bank activities in the energy sector, and call upon all parties concerned to consider every possible means of increasing the financing of this key sector, including establishment of the "Energy Affiliate".

Moreover, they hold that the development of the energy and industrial sectors is particularly well suited for regional cooperation.

The industrialization policy of African countries should aim first and foremost at promoting the processing of local primary products. This industrialization policy should also seek to ensure the satisfaction of the domestic demand and the competitiveness of manufactured goods for export.

They reiterate that the regional cooperation recommended in the Lagos Plan of Action is the cornerstone and provides the framework necessary for the harmonious and autonomous development of Africa.

7. The African Governors note with satisfaction the idea of a substantial increase in real terms of the transfer

of official resources for the development of Sub-Saharan Africa.

However, they consider that this should not prejudice the proposed decisions in favor of the least developed countries.

The African Governors welcome the proposal in the World Bank Report with respect to doubling in real terms the transfer of official resources set aside for this part of Africa during the 1980's.

This transfer should apply, in particular, to the three following areas:

(a) project financing in agriculture, irrigation, industry, energy, transport and communications, mining, education, training and health;

(b) non-project financing to rehabilitate the productive capacities of African countries. This non-project financing can take the form of structural adjustment lending and of program lending; the increase of IMF should better contribute to the support of the balance of payments.

(c) rescheduling, refinancing or cancellation of the external public debt of African countries.

Concerning such an increased transfer of resources, precise commitments must be made so that the African countries may be assured as to the volume of this allocation during this period.

Moreover, donors should take all necessary steps to finance during this decade the bulk of counterpart funds in local currency required for the projects.

They should also bear part of the recurrent costs of the projects.

8. The African Governors note with satisfaction the World Bank's undertaking to allocate 30% of IDA funds to Sub-Saharan Africa.

This percentage is only significant for African countries if IDA resources continue to grow substantially in real terms from one replenishment to the next.

Therefore, they profoundly regret the reduction in the IDA lending program for fiscal year 1982, and the uncertainties and dangers that hang over the resources of the Association and the very future of this primary source of development financing for the poor countries.

They urgently call upon all donor countries to fully meet their commitments under the Sixth Replenishment.

They urge the World Bank and the donor countries to begin negotiations as soon as possible on the Seventh Replenishment of IDA resources.

They emphasize the need to initiate a study to devise an appropriate mechanism for replenishing IDA resources so that the Association may become a secure and steady source of aid to the poorest countries.

9. The African Governors consider that domestic efforts alone will not be sufficient to accelerate development in Africa. These efforts must be complemented by a notable increase in the transfer of resources for development.

Both are equally necessary but neither should be pre-conditional upon the other. Success can only be achieved through consultations and negotiations.

Therefore, the African Governors believe that the World Bank can act as an intermediary and a catalyst between the international community and Africa.

To achieve this end, a wider dialogue must be established between Africa and the international community with the help of the World Bank.

10. African Governors are of the opinion that certain questions have not been dealt with in the World Bank Report: problems such as the soaring of interest rates in the international financial markets, global negotiations with a view to establishing a new international economic order, and stabilization of commodity prices.

Within the framework of the integrated program of UNCTAD, the rise of protectionism in industrialized countries and the indebtedness of developing countries are essential elements to be taken into account in the search for acceptable solutions of the development problems of Africa and of the world.

DAKAR, March 3, 1982
The African Group of the Boards of Governors
of the World Bank and the International
Monetary Fund.

[illegible]

DAKAR, March [illegible]

The African group of the [illegible]

of the World Bank [illegible]

Monetary Fund.

IMMEDIA

FROM: ROBIN HARRIS
DATE: 1 April 1982

PRINCIPAL PRIVATE SECRETARY — 2                    c Mr Ridley

**DRAFT LETTER TO SCOTTISH CONSERVATIVE MPs**

... As the Chancellor requested, I attach a draft letter.

I will let you have a list of Scottish Tory MPs in the course of Friday.

RH

ROBIN HARRIS

C.

1. Best from a Special Adviser, surely, if from the Treasury at all?
2. The right answer, I'd have thought, is for us to agree ~~with~~ with the Scottish Office a low key factual "erratum slip", covering all the mistakes. And the Scottish Office may well have done it themselves.
3. Not a letter from you: too ignominious.

[illegible] 2/iv.

Under cover of a note from the Scottish Whip.

"I know our colleagues will, as I did, have found it v. useful to have ... [illegible] ... [illegible] ..."

Attn P.B. if he agrees, then fine

Perhaps best to accompany with a covering note: "Please forgive [illegible] ... [illegible] ... which crept into ..."

DRAFT LETTER FROM: THE CHANCELLOR

TO : SCOTTISH CONSERVATIVE MPs

I am afraid that, ~~as you may have noticed,~~ several errors crept into the briefing which we circulated on aspects of the budget relating to Scotland. The section on 'inner cities' did not apply to Scotland and should be ignored.

This briefing was prepared under fairly intense pressure and was not properly checked before distribution. In general, I hope that you would agree that the idea of instant briefing on Scotland available at the close of the budget speech is a valuable one. It would, of course, be rather more valuable if the briefing were entirely accurate and we will make every attempt to ensure that in future.

CONFIDENTIAL

From: R J Bonney
Date: 26 April 1982

PRINCIPAL PRIVATE SECRETARY

cc: PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Littler
Mr Carey
Mr Lavelle
Mr Beastall
Mr Bottrill
Mr Ridley
Mr Woodman

WORLD BANK GENERAL CAPITAL INCREASE

Further to my note of 23 April you asked which FCO Ministers have agreed to the recommendation that we accept the World Bank's proposal for the reallocation of half the UK's GCI shares.

2. I understand from ODA that only Mr Marten has so far approved the recommendation. Their original intention had been to secure Mr Hurd's agreement as well and I have suggested that they should now do this. The FCO's diplomatic wing have been involved in the discussions of this question at official level and they see no reason why Mr Hurd should object to what is proposed.

RJ Bonney

R J BONNEY

CONFIDENTIAL

cc: PS/CST
PS/FST
PS/EST
Sir D Wass
Sir K Couzens
Mr Littler
Mr Lavelle
Mr Beastall o/r
Mr Bottrill o/r
Mr Ridley
Mr Woodman
Mr Bonney

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

26 April 1982

Michael Scholar Esq.
10 Downing Street
LONDON
SW1

Dear Michael,

WORLD BANK GENERAL CAPITAL INCREASE

The World Bank are currently undertaking a general capital increase, approved in January 1980, to double their capital to $ 80 billion. Some 90 per cent of the GCI shares were to be allocated to member countries in proportion to their existing subscriptions. The Prime Minister may wish to know that Treasury and FCO Ministers have now agreed to accept a proposal from the World Bank that we should give up half the new shares allocated to us. This is one of the rare occasions when we can save public expenditure (at least £60 million) and reduce the multilateral element in the aid budget, while at the same time gaining credit for helping the Bank (which needs the shares to satisfy other claimants such as Saudi Arabia.)

The Chancellor has carefully considered the implications for our position in the IMF because of the traditional link between shareholdings in the two Bretton Woods institutions. It is of course in our general interest to maintain as high as IMF quota as we legitimately can, although our relative position is likely to fall in the long run because of the decline in our relative economic strength. However, because of the special circumstances surrounding the Bank's request, agreeing to it should not prejudice our negotiating position in the current IMF Quota Review. If in the forthcoming Aid Framework discussions Ministers decide to take up the other 50 per cent of the shares allocated to us under the general capital increase, we would still remain comfortably in second place among the shareholders in the Bank.

/Copies of

Copies of this letter go to Brian Fall (FCO), Jonathan Spencer (DOI), John Rhodes (DOT) and David Wright (Cabinet Office).

Yours ever,

John Kerr.

J.O. KERR
Principal Private Secretary

CONFIDENTIAL

From: J O KERR
28 April 1982

PWP

cc PS/CST
PS/FST
PS/EST
Sir D Wass
Sir K Couzens
Mr Littler
Mr Carey
Mr Lavelle
Mr Beastall
Mr Bottrill
Mr Ridley
Mr Woodman

MR BONNEY

WORLD BANK GENERAL CAPITAL INCREASE

We have spoken about your minutes of 21, 23 and 26 April. As you know, I wrote to Mr Scholar on 26 April: he has today confirmed that the Prime Minister has no objection to the proposal that we should give up half the new shares allocated to us under the GCI. The draft telegram to Washington which was attached to your minute of 21 April could therefore now issue.

JOK.

J O KERR

CONFIDENTIAL

(PWP)

EXCHEQUER
30 APR 1982

10 DOWNING STREET

From the Private Secretary

PS/CST, PS/FST, PS/EST, Sir A Wass, Sir K Couzens, Mr Littler, Mr Lavelle, Mr Beastall, Mr Bottrill, Mr Ridley, Mr Woodman, Mr Bonney

29 April, 1982.

Dear John,

World Bank General Capital Increase

Thank you for your letter of 26 April about the World Bank General Capital Increase.

I have shown this letter to the Prime Minister, who has noted it without comment.

I am sending copies of this letter to Brian Fall (Foreign and Commonwealth Office), Jonathan Spencer (Department of Industry), John Rhodes (Department of Trade), and David Wright (Cabinet Office).

Yours sincerely,

Michael Scholar

John Kerr, Esq.,
HM Treasury.

CONFIDENTIAL

57/4

CONFIDENTIAL

Chancellor

FROM: L J WOODMAN
DATE: 29 April 1982

1. MR BONNEY
2. MR BEASTALL JB 30/4

cc PS/Chief Secretary
Sir K Couzens
Mr Littler
Mr Carey
Mr Slater

SIXTH REPLENISHMENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION (IDA6)

The Minister of Finance of Senegal, M. Ousmane Seck, in his capacity as Chairman of the African group on the Board of Governors of the World Bank and the IMF, wrote to the Chancellor on 25 March principally to draw attention to the delays in IDA6. /The letter was sent by diplomatic bag and did not reach the Treasury until after Easter./

2. Since M. Seck wrote his letter, the UK has decided to waive the pro rata provision in respect of our second (current) instalment to IDA6 and this, of course, adds substantially to IDA's commitment authority. The President of the World Bank has thanked the UK for taking a lead on this matter; our action has apparently been followed by ten or so other donor countries.

3. I attach a draft reply for the Chancellor's signature. The draft has been cleared at official level by the FCO, Bank of England and the ODA. The FCO have pointed out that the Republic of Senegal has been very helpful to the UK over the Falkland Islands crisis, providing refuelling facilities etc for RAF aircraft among other things. Indeed, the Prime Minister recently sent a message of thanks to the President of Senegal. In view of this, the FCO suggest that the Chancellor might sign off the letter with something a little more effusive than "Yours sincerely". They suggest something like "With warmest best wishes".

LJ Woodman

L J WOODMAN

CONFIDENTIAL

DRAFT LETTER FROM: CHANCELLOR

TO: MONSIEUR ~~M.~~ OUSMANE SECK
Minister of Finance
Republic of Senegal

Pl. type 5/4

Thank you for your letter of 25 March 1982 on behalf of the African group on the Board of Governors of the World Bank and the International Monetary Fund.

2. Many thanks for letting me have a copy ~~I was grateful to receive a copy~~ of the African caucus' memorandum ~~of the African Caucus of the World Bank and the IMF~~ on the World Bank's report ~~entitled~~ on "Accelerated Development In Sub-Saharan Africa: An Agenda For Action". ~~which we will study~~ We are studying this with care. As you know, we have already welcomed the World Bank's report as an important and useful basis for discussion on the development of Sub-Saharan Africa.

3. On ~~the~~ your particular point ~~you raise~~ about the release of contributions to the Sixth Replenishment of the International Development Association, as you know under the terms of the original IDA 6 Agreement contributions could only be used in proportion to the contributions appropriated by the United States. However, we recognize the importance of IDA credits to the economies of many of the poorest countries and in particular those in Africa ~~. For this reason~~ and that was why ~~the UK~~ we joined with other countries in making advance contributions to IDA 6 before full ratification of the Agreement.

4. In the light of the strong representations made to us on behalf of all IDA recipients by the Prime Minister of India and other Heads of Governments, we agreed last month to waive the <u>pro rata</u> provision in respect of our second (current) instalment to IDA 6. ~~and~~ This means that £370 million of the UK's contribution of £555 million to IDA6 is now available

for commitment. We understand from the President of the World Bank that as many as ten other donor countries may follow our lead. ~~and that~~ This ~~would~~ should add substantially to IDA's resources for this year.

/G HOWE/

29/24

CONFIDENTIAL

BRITISH EMBASSY

PARIS

4 May 1982

SECOND PERMANENT SECRETARY'S OFFICE
OVERSEAS FINANCE SECTOR

| ACTION | |
|---|---|
| COPIES TO | Mr Littler |
| | Mr Lavelle |
| | Mr Bothwell |

Sir Kenneth Couzens KCB
Second Permanent Secretary
HM Treasury
Parliament Street
London

Dear Ken.

TRIPOLAR INTERNATIONAL MONETARY SYSTEM

I enclose a paper on this subject which I received today from Michel Camdessus.

Yours ever,

Len.

L V Appleyard

(Enc)

MINISTÈRE DE L'ÉCONOMIE

DIRECTION DU TRÉSOR

LE DIRECTEUR

PARIS, LE 4 Mai 1982

Mon Cher Kenneth,

Je vous adresse comme convenu, avec un peu de retard, je m'en excuse, la version écrite de mon exposé des 24 et 25 avril dernier, dans la perspective de notre prochaine réunion du 14 mai.

J'espère que vous voudrez bien m'adresser prochainement vos réflexions qui permettront d'enrichir ces premières idées, formulées à titre personnel.

Je vous propose que nous nous retrouvions le 14 mai à 13 H 30 à Paris pour déjeuner et que nous poursuivions ensuite nos travaux jusque vers 17 H.

Croyez, Mon Cher Kenneth, en mes sentiments amicaux.

Michel CAMDESSUS

P.S. : Je vous adresse le texte français que j'ai rédigé, et une traduction approximative en anglais que j'ai fait faire rapidement pour vous faciliter les choses.

Sir Kenneth COUZENS
LONDRES

# ESQUISSE DE PROPOSITIONS POUR UNE ORGANISATION MONETAIRE INTERNATIONALE TRIPOLAIRE

-*-*-

Nous sommes tous aujourd'hui la recherche d'une plus grande stabilité monétaire.

La stabilité monétaire et la prospérité économique sont indissolublement liées comme l'a montré l'histoire monétaire; la stabilité monétaire et la liberté des échanges le sont aussi comme l'a montré l'histoire commerciale.

La reconstruction, à un horizon certes pas immédiat mais peut-être de quelques années, d'un système inspiré de l'esprit de Bretton Woods et fondé sur des taux de change stables et ajustables faciliterait le retour à une croissance non inflationniste et la réduction progressive du chômage.

Nous savons bien que trop de tentatives restées sans lendemain, au cours des années récentes, ont répandu le scepticisme sur une telle entreprise. Nous devons donc être modestes dans nos premières ambitions si nous voulons donner toutes ses chances à une initiative en ce domaine. Il faudrait, en tous cas, essayer de partir d'une analyse commune des réalités et ne tenter dans l'immédiat que ce qui est possible. Cette prudence ne devrait pas nous empêcher de commencer à agir. Une réorientation, même peu spectaculaire, de nos pratiques actuelles pourrait marquer notre résolution, surtout si elle était éclairée par une vision commune de ce que pourrait être, à moyen terme, un système monétaire international rénové.

Nous pourrions ainsi engager deux sortes d'actions :

- l'une à court terme, qui ne serait que le renforcement de notre concertation actuelle;

- l'autre à moyen terme fondée sur la coopération entre les trois grands pôles constitués par le Dollar, l'Ecu et le Yen.

Comme la claire vision de cet horizon à moyen terme peut renforcer notre action à court terme, je commencerai par essayer de l'esquisser.

*

*     *

.../

## I - PERSPECTIVES A MOYEN TERME D'UN SYSTEME TRIPOLAIRE

Le souci de réalisme dans la définition de l'horizon à moyen terme doit nous amener à le fonder sur deux éléments majeurs :

- l'existence bien établie maintenant et pour un avenir durable de trois grands pôles monétaires : Dollar, SME, Yen;

- notre accord pour considérer que des relations de change stables mais ajustables entre ces pôles ne peuvent se fonder que sur une convergence accrue des politiques économiques, complétée, si nécessaire pour des montants et à des moments appropriés, par des interventions de banques centrales, mais non l'inverse :

A partir de ces fondements, on aperçoit bien l'allure que pourra prendre l'organisation monétaire nouvelle :

1 - les trois pôles monétaires, avec la possibilité pour les autres monnaies de s'associer à l'un d'entre eux ou de se rattacher au DTS;

2 - des liens entre les pôles monétaires : ces liens assez lâches au départ seraient progressivement resserrés en fonction des progrès accomplis dans l'assainissement des économies et des premiers résultats du nouveau système de change. L'objectif serait d'aboutir au bout du processus à des taux de change interpolaires stables mais ajustables. Le respect de ces liens entre les pôles serait assuré de la manière suivante :

   a) à titre principal, l'ajustement concerté des politiques économiques serait le prolongement naturel de la concertation étroite et régulière qu'il est proposé de mettre en place dès maintenant entre les trois pôles;

   b) plus accessoirement, pour assurer la crédibilité du système, le réseau actuel de concours mutuels entre banques centrales serait progressivement renforcé. La taille des concours potentiels serait accrue progressivement de façon à ce qu'ils atteignent au minimum la valeur relative qu'ils avaient au début des années 1960. Les formes de coopération entre banques centrales seraient autant que nécessaire, renouvelées.

3 - renforcement de la "ferme surveillance du FMI"; en effet, le rôle que pourrait jouer le DTS confère une responsabilité particulière de stabilité aux cinq monnaies qui le composent et il va de soi que les pays responsables de ces monnaies devraient se prêter à cette surveillance multilatérale accrue; ainsi serait apporté une réponse plus concrète à la critique des pays en développement qui protestent contre le fait que la surveillance qui s'exerce sur eux à la faveur de la conditionnalité des programmes est plus forte que celle qui s'exerce sur les grandes monnaies ou les pays à surplus.

Le F.M.I. assumerait donc dans cette perspective une mission plus vaste; il devrait donc être confirmé dans son indépendance et suffisamment renforcé dans ses moyens pour bénéficier de toute la crédibilité nécessaire.

..../

## II - LE RENFORCEMENT IMMEDIAT DE LA COOPERATION MONETAIRE INTERNATIONALE

Toute initiative vaut par la perspective dans laquelle elle s'inscrit mais plus encore par la façon résolue dont on l'engage. Si nous sommes donc décidés à aller dans cette direction, il est important de le faire savoir à nos opinions publiques qui nous reprochent notre apparente indifférence devant le désordre actuel. Les marchés des changes ne seront pas indifférents à ce message et ceci pourra constituer un premier élément de plus grande confiance dans des progrès possibles vers la stabilité.

Ce message devrait s'accompagner de premiers pas concrets manifestant notre souci commun de renforcer la coopération monétaire internationale.

Ces premiers pas pourraient consister dans la mise en place d'une concertation sur l'évolution relative en des données économiques fondamentales des taux de change et en une affirmation suffisamment solennelle de quelques règles de bonne conduite qu'implicitement, nous acceptons déjà ou auxquelles nous nous sommes d'ores et déjà engagés à nous tenir.

### a) Une concertation renouvelée

Une meilleure convergence des politiques économiques est une condition essentielle à la mise en place d'un système de parités plus stables. L'effort commun de l'ensemble des partenaires en ce domaine facilitera le rapprochement progressif des taux d'intérêts réels, des taux de change et de l'évolution des grandeurs caractéristiques de l'économie et évitera les fluctuations de grande ampleur que nous venons de connaître.

Pour hâter cette convergence, il pourrait être décidé de renforcer et de rendre plus systématique l'examen en commun de l'évolution relative des données économiques fondamentales des taux de change et des taux d'intérêt. On pourrait imaginer que cette concertation s'établisse à une périodicité suffisamment régulière avec la participation du F.M.I.

A cette concertation à périodicité régulière pourrait s'ajouter une concertation exceptionnelle, mais à caractère automatique, dans le cas où l'une des monnaies qui constituent le DTS viendrait à s'éloigner de façon nette de l'évolution moyenne des autres.

Cette concertation s'effectuerait selon des modalités - notamment de discrétion - appropriées. Le Directeur Général du F.M.I. serait incité à publier un rapport annuel particulier sur la situation de ces cinq monnaies et leurs rapports de change.

.../

b) Les engagements de bonne conduite

Certains engagements souscrits dans le passé revêtent aujourd'hui une importance particulière. Il est donc utile de les réaffirmer. Il s'agirait en fait de rappeler que les principaux pays industriels continuent de souscrire à certains engagements qu'ils ont acceptés dans le passé s'expriment en termes simples.

1 - Nous considérons tous la stabilité des marchés des changes comme notre responsabilité commune et nous sommes résolus à l'assumer ensemble et en étroite liaison avec tous les pays et toutes les organisations intéressées.

2 - Nous excluons l'utilisation de nos taux de change aux fins de gagner des avantages compétitifs.

3 - Nous sommes prêts à avoir recours, si nécessaire, à des interventions, dans les conditions prévues à l'article IV des statuts du F.M.I. pour éviter des fluctuations erratiques.

4 - Nous sommes prêts à renforcer notre coopération avec le F.M.I. pour que sa "ferme surveillance" spécialement sur les monnaies qui constituent le DTS contribue à la stabilité et à la crédibilité de celui-ci.

5 - Nous sommes prêts à donner au F.M.I., à un moment où sa tâche est plus que jamais nécessaire, les moyens de sa mission et de son indépendance.

6 - Nous nous sommes résolus à faire progresser d'un même pas stabilité monétaire international et liberté des échanges : elles sont indissolublement liées.

*

*　　*

Compte tenu de cette commune vision de nos objectifs à moyen terme, de nos perspectives d'action immédiate et des engagements auxquels nous souscrivons, nous pourrions décider de lancer l'étude d'une reconstruction du système monétaire fondée sur ces objectifs, ces perspectives et ces engagements.

# OUTLINE OF PROPOSALS FOR A THREE-POLE INTERNATIONAL MONETARY SYSTEM

-----------

We are all of us today seeking ways to increase monetary stability.

Past experience demonstrates to us that monetary stability and economic prosperity are very closely linked, as are monetary stability and free trade.

The reconstruction of a system in the Bretton Woods spirit and based on stable but adjustable exchange rates, would greatly facilitate the return to non-inflationary growth and help the progressive reduction of unemployment ; this obviously could not be accomplished immediately but perhaps over a period of a few years.

We are all aware that too many attempts made over the past years have been short-lived and have indeed raised scepticism on the prospects of such an attempt. Therefore we have to remain modest when fixing our initial objectives if we want to give this new initiative a chance to succeed. In anycase we must start by a joint analysis of realities and limit our early efforts to what appears feasible. Such a cautious approach should not however prevent us from taking action. Without being necessarily spectacular, a reorientation of our current practices would undoubtedly indicate our determination, especially if it were inspired by a joint perception of what could be, in the medium term, a renewed international monetary system.

Two kinds of actions could thus be undertaken :

- in the short run, we would aim at reinforcing our present cooperation ;

- in the medium run, we would act so as to foster the cooperation between the three major poles, namely the dollar, the ECU and the Yen. Since a clear perception of our medium term target could certainly strengthen our short term action, I will start by trying to outline it.

## I - Medium-term prospects of a three-pole system.

To be realistic enough, the definition of our medium-term target requires that we found it upon two main elements:

- the first, which is now well-established and will remain so in the foreseeable future, is the presence of three major monetary poles : Dollar, EMS , Yen ;

./.

- the second lies in our agreement that stable but adjustable relations between these poles can only be secured by an increased convergence of economic policies , such a convergence being supplemented, if and whenever necessary and for appropriate amounts, by central banks interventions , and not the other way around.

We can easily draw the main features of the new monetary system which could be built upon these foundations :

1 - The three monetary poles would be placed at the core of the system, the other currencies would have then the option of associating themselves with any one of the poles or the S.D.R. ;

2 - A set of links would inter-relate the monetary poles; rather loose at the outset, these links would be progressively reinforced along with progress accomplished in strengthening economies and the first results achieved by the new exchange system. The ultimate objective of the process would be to reach stable but adjustable intrapolar exchange rates. The smooth working of these links between the poles would be secured :

a) principally, by concerted adjustment of economic policies which would be the natural follow-up of the close and regular cooperation process that could be set up right now between the three poles ;

b) in addition, in order to enhance the system's credibility, the present mechanism of mutual loans established by central banks would be progressively reinforced. The size of the potential loans would be gradually increased until it reached at least the relative value it had in the early 60's. The forms of cooperation between the central banks would be periodically reviewed and if necessary renewed.

3 - The IMF firm surveillance would be strengthened ; the role that the SDR may indeed play gives the five currencies which compose it a particular responsability with regard to stability, and consequently national authorities of the countries responsible for the five currencies involved should accept an increased multilateral surveillance ; such a system would thus concretely reply to the criticism expressed by developing countries which complain that the surveillance imposed on them through the conditionality attached to the IMF programs is firmer than that which weighs on the main currencies and the surplus countries.

In this context the IMF would fulfill a wider role ; its independance would have to be reaffirmed and its instruments would have to be strengthened so that its credibility be adequately established.

./.

## II - Immediate strengthening of international monetary cooperation.

The value of an initiative may indeed be assessed by its long-term prospects but even more by the determination with which it is launched.

If we are determined to proceed in this direction, it is important to inform our countries' public opinion since we are accused of being apparently indifferent to the present disorder. The exchange markets will not fail to take note of the message and that could indeed be a first step in rebuilding confidence in the possibility of progressing towards stability.

The affirmation of our will to rebuild a stable system should be accompanied by first concrete actions exhibiting our common resolve to strengthen immediately international monetary cooperation.

These first actions could consist, on the one hand, in the setting up of a renewed consultation framework and on the other in the confirmation - which should be sufficiently formal - of a few rules of good conduct that we already implicitly respect or that we have already committed ourselves to comply with.

a) A renewed consultation process. A better convergence of economic policies represents an essential condition for the establishment of a more stable par-value system. Joint efforts displayed in this field by all partners will little by little generate closer real interest rates, exchange rates and economic fundamentals ; large-scale fluctuations similar to those recently witnessed would thus be prevented.

In order to speed up this convergence process, we could decide to reinforce and make more regular the joint assessment of the relative evolution of basic economic data, exchange rates and interest rates. We could imagine that this consultation process be established with an appropriate degree of regularity between the five countries involved and with IMF participation. It should obviously be a high-level consultation.

Exceptional though automatic consultations - which would be triggered whenever one SDR currency diverges from the average evolution of the others could be added to the regular ones.

Those consultations would take place in compliance with appropriate procedures - notably in the field of confidentiality.

The IMF managing Director would also be invited to release an annual report on the specific situation of the five currencies and their exchange relations.

./.

b) "Good conduct" commitments. Some commitments made in the past are today of utmost importance. It is therefore useful to reaffirm them. They can be expressed in simple terms :

1 - we believe that stability on exchange markets is our joint responsibility and we are determined to jointly fulfill it in close collaboration with all interested countries and institutions.

2 - we rule out the use of exchange rates for competitive purposes.

3 - we are ready to resort, if necessary, to interventions under those conditions provided for in article IV of the IMF Articles of Agreement to avoid erratic fluctuations.

4 - we are ready to reinforce our cooperation with the IMF so that its firm surveillance, of the SDR currencies in particular, contributes to stability and to the IMF credibility.

5 - we are ready to give the IMF, at a time when its task is more important than ever, the means necessary to fulfill its role and secure its independence.

6 - we are determined to increase at the same-time international monetary stability and free trade which are closely linked.

Given our common perception of medium term objectives and immediate action prospects as well as our common "good conduct" commitments, we could decide to launch a study on the reconstruction of the monetary system based on these objectives, prospects and commitments.

cc: PS/CST
Sir K Couzens
Mr Littler
Mr Carey
Mr Slater
Mr Bonney
Mr Beastall
Mr Woodman

MY

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

7 May 1982

Monsieur Ousmane Seck
Minister of Finance
Republic of Senegal

Dear Colleague

Thank you for your letter of 25 March on behalf of the African group on the Board of Governors of the World Bank and the International Monetary Fund.

I am grateful to you for letting me have a copy of the African Caucus' memorandum, which I am studying with keen interest, on the World Bank's report on "Accelerated Development in Sub-Saharan Africa: An Agenda for Action". As you know, the United Kingdom has already welcomed the World Bank's report as an important and useful basis for discussion of the development of Sub-Saharan Africa.

I have particularly noted the point made in paragraph 8 of the memorandum about the release of contributions to the Sixth Replenishment of the International Development Association. As you know, under the terms of the original IDA 6 Agreement, contributions could only be used in proportion to the contributions appropriated by the United States. However, the United Kingdom recognises the importance of IDA credits to the economies of many of the poorest countries and in particular those in Africa: that was why we joined with other countries in making advance contributions to IDA 6 before full ratification of the Agreement.

Moreover, in the light of strong representations made to us on behalf of all IDA recipients by the Prime Minister of India and other Heads of Government, we agreed last month to waive the pro rata provision in respect of our second (current) instalment to IDA 6. This means that £370 million

/of the United Kingdom's

of the United Kingdom's contribution of £555 million to IDA 6 is now available for commitment. I have been encouraged to hear from the President of the World Bank that as many as ten other donor countries may follow our lead. This should add substantially to IDA's resources for this year.

With warmest good wishes,

Yours sincerely

Geoffrey Howe

GEOFFREY HOWE

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

9 June 1982

Patrick Ide Esq
Theatre Investment Fund Limited
18/20 Maiden Lane
LONDON
WC2E 7NH

Dear Mr Ide

Alistair McAlpine recently passed me a copy of the letter you had written to me on 2 December 1980 shortly after our lunch with Peter Saunders on 25 November. I fear that your original letter went astray - hence the appalling delay in letting you have a reply. Please accept my apologies.

I recognise the important contribution the Fund has made, within the limited resources available to it, to the commercial theatre through its financial support of worthwhile new productions and revivals. Equally I appreciate the Fund's desire to play a more active role in influencing the choice of productions by becoming a primary source of venture capital rather than a lender of last resort. But I am bound to say that there would be very real difficulty in providing any substantial contribution to the Fund's working capital from public funds. It is, of course, for Paul Channon to determine the priorities within his arts budget, but as you are fully aware he is faced with many competing claims on what are inevitably only limited resources. And the kind of sum you have in mind is not insignificant in absolute terms and large in relation to the Art Council's 1982-83 grant of £86 million. I could not hold out any hopes of additional resources being made available for the arts budget.

Some of the problems you identified may have diminished in the period since your original letter. The initiatives taken by Norman St John Stevas and pursued by Paul Channon to encourage private and commercial sponsorship should have started to pay dividends. And the clarification of the law with regard to advertising and business sponsorship in the 1980 budget will also have been helpful in this respect.

/On one final

On one final note I wonder whether there is any way in which the more successful commercial productions could be encouraged to support the more innovative kind of productions through the Theatre Investment Fund. I expect you have already considered this but, if not, it might be worthwhile exploring the possibility.

I am sending copies of our correspondence to Paul Channon, because of his direct responsibility for arts expenditure, and to Alistair McAlpine.

Yours ever

GEOFFREY HOWE

Geoffrey Howe

cc MR FRENCH 22/6

# THEATRE INVESTMENT FUND LIMITED

(Limited by Guarantee)

Telephone
836 9245

18/20 Maiden Lane,
London,
WC2E 7NH

cc CH/ex

CH/EXCHEQUER
REC. 21 JUN 1982
ACTION MR. I. SMITH
COPIES TO

PI:ms

16th June, 1982.

44983

Sir Geoffrey Howe,
Treasury Chambers,
Parliament Street,
LONDON SW1P 3AG

2

Dear Sir Geoffrey,

I have to thank you for your very full letter of 9th June and for your apology for the delay that has inexplicably occurred.

I note that you have sent copies of your letter to Paul Channon and to Alistair McAlpine.

I have forwarded a copy of my letter to my Chairman Lord Goodman and it will be considered by my Committee of Management on its next meeting on July 2nd.

Yours sincerely,

Patrick Ide

**Patrick Ide.**

*Directors*

The Lord Goodman C.H. (Chairman) Sir Peter Saunders (Vice-Chairman)
Sir Emile Littler J. W. Lambert C.B.E., D.S.C. Stuart Burge C.B.E. Thelma Holt Laurier Lister O.B.E.
Patrick Ide (Managing Director) Secretary: Robert Breckman F.C.A.

*Consultants*

Stephen Mitchell Charles Vance John Mortimer Q.C. Barrie C. Stead David Jackson The Hon. R. Alistair McAlpine

Registered Office: 49 South Molton Street, W1Y 1HE Registered in England No. 1252595 Charity Reg No. 271349

cc Mr E Fraser(?)

# THEATRE INVESTMENT FUND LIMITED

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Telephone
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cc CM/...

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Yours sincerely,

Patrick Ide.

Directors
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Sir Emile Littler L. W. Lambert C.B.E., D.S.C. Stuart Burge C.B.E. Toby Rowland(?) Laurier Lister O.B.E.
Patrick Ide (Managing Director) Secretary: Robert Leckie(?) F.C.A.

Consultants
Stephen Mitchell Charles Vance John Mortimer Q.C. Barrie C. Stead David Jackson The Hon. R. Alistair McAlpine

Registered Office: 40 South Molton Street, W1Y 1HE Registered in England No. [illegible] Charity Reg No. [illegible]

FROM THE PRESIDENT - GEOFFREY E. MOORE, CBE

**SMMT** THE SOCIETY OF MOTOR MANUFACTURERS & TRADERS LTD.

FORBES HOUSE · HALKIN ST.
LONDON SW1X 7DS
TELEPHONE 01-235 7000

22 June 1982

TOP
CC CH/EX

CH/EXCHEQUER
REC. 25 JUN 1982
ACTION PS/IR
COPIES TO FST
45050

The Rt. Hon. Sir Geoffrey Howe, QC, MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London SW1P 3AG

Dear Chancellor,

Thank you for your letter of 10th June and for the consideration you have given to our representations on your proposals for car and car fuel benefit scales.

We note your points on the effect of your proposals on the individual but, as I am sure you understand, our major concern is to balance this factor with the effect that the proposed increases could have on the demand for the UK motor industry's products.

I have put your arguments against changing the proposed increases in car benefit scales and reducing the proposed fuel benefit scale to our Taxation Committee where they will be given careful thought. If it is felt that a response could usefully be made at this stage, we shall put our ideas to your officials. Your reference to "fairness" in your comments on reimbursement of petrol received is noted and I hope that this same concern will apply to considerations in other contexts, such as the discrimination that at present is applied against the products of the motor industry. I am sure that my successor will be taking this matter up with you later in the year.

Again, my thanks for your thoughtful and detailed reply to my letter.

Sincerely,

Geoffrey Moore

C

CONFIDENTIAL

FROM: C D HARRISON
23 June 1982

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir Douglas Wass
Sir William Ryrie
Mr Middleton
Mr Monck
Mr Pirie
Mr Boote
Mr Ridley

NEW CLAUSE 42: TAXATION OF BANKS

Yesterday, Mr Jack Straw MP wrote a manuscript note to the Chief Secretary saying that when New Clause 42 is discussed in Finance Bill Committee tomorrow (Thursday), he hopes that Treasury Ministers will be able to "provide further details of the Government's thinking on future taxation of the banking sector following the Chancellor's statement during the course of the Budget Speech".

2. The Economic Secretary, who will be taking this clause, proposes to take the line that at this stage there is nothing to add to what the Chancellor said in his Budget speech; and no useful purpose would be served in trying to do so before the Government had considered the issues fully. Could you please confirm that the Chancellor is content?

? Yes

CDH

C D HARRISON
Private Secretary

CONFIDENTIAL

C/.

Note
Passed comments to FST's Office.
JR
8/7

FROM: D L WILLETTS
DATE: 7 July 1982

PRINCIPAL PRIVATE SECRETARY — 2

cc PS/CST
PS/EST
PS/MST(R)
PS/MST(C)
OK by → Mr Middleton ? If so, OK by me
Mr Robson
Mr Hall
Mr French
Mr Harris
Mr Ware - IR

PROPOSED PRESS RELEASE: CORPORATE BONDS

The Financial Secretary would be grateful for the Chancellor's approval to issue the attached Press Release through Conservative Central Office tomorrow. The text reflects official comments on an earlier draft. It would be particularly helpful to have the Chancellor's response by 10.30 am if possible.

D.L.W.

D L WILLETTS
7 July 1982

EXTRACT FROM A SPEECH BY NICHOLAS RIDLEY, FINANCIAL SECRETARY TO THE TREASURY TO SOUTH CROYDON CONSERVATIVE LADIES LUNCHEON CLUB ON THURSDAY 8 JULY AT 1PM

I hope both Industry and the City will come to see the potential of new forms of corporate borrowing such as deep discount bonds, zero coupon bonds and indexed bonds. We have made the tax position clear. Their significance will grow as companies and investors begin to see the benefits on offer. I hope it won't once again be foreign borrowers who are first to see the advantages of these new forms of finance.

Trying to channel more resources into the company sector is second nature to a Government which believes so firmly in the virtues of private enterprise. A higher level of investment in British Industry is the way to achieve higher productivity and thereby greater profitability. It is the only sure way on the long run towards better employment prospects, too.

It is not the Government's role to direct investment, only to provide the appropriate opportunities wherever it can. We want to provide new opportunities for comapnies and to investors, and to give them the maximum range of instruments to choose from. This is what we sought to do a fortnight ago.

So for the first time industrial companies may now borrow substantial sums of money without the strain on their cash flow of finding full interest payments immediately. By issuing deep discount and zero bonds they can benefit from the money before they have to pay for it fully. It is a 'balance sheet breather' until the new developmentor machinery or other asset in which they have invested starts to pay its way. It will usually be cheaper overall for them to do this, and the tax man will get correspondingly less revenue - but that should be an encouragement to industry to invest.

It is an especially useful opportunity for tax exhausted comapnies. Too many of our manufacturing companies have no UK taxable profits against which to offset loan interest. For them capital allowances have ceased to offer a relevant investment incentive.

If the opportunity is seized it will moderate the level of borrowing from the banks. Huge company overdrafts and so-called 'hard core' borrowing should in due course give way to private funds as companies issue long term debt to raise money in the capital markets instead. Our declining interest rates must also help this process.

For the Government itself, the changes offer greater flexibility in restraining money supply - a necessary weapon in the battle to keep inflation on a downward path.

[illegible] useful opportunity for the [illegible].
[illegible] companies have no UK taxable profits
[illegible] interest. For those [illegible]
[illegible].

[illegible] will [illegible] the level of [illegible]
[illegible]
[illegible]
[illegible]
[illegible].

[illegible]
[illegible]
[illegible].

CONFIDENTIAL

FROM: ROBIN HARRIS
14 July 1982

CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
ECONOMIC SECRETARY
MINISTER OF STATE (C)
MINISTER OF STATE (R)
SIR D WASS
SIR K COUZENS
SIR A RAWLINSON
SIR W RYRIE
MR BURNS
MR MIDDLETON
MR KEMP
MR HALL
MR RIDLEY
MR FRENCH

cc Sir L Airey - IR
Sir D Lovelock - C&E

NOTE OF A MEETING OF THE CONSERVATIVE PARLIAMENTARY FINANCE COMMITTEE: 13 JULY 1982

The meeting was addressed by Sir Terence Beckett, Director General of the CBI.

Sir Terence said that the CBI's proposals for the last budget were moderate, in spite of pressure internally from a powerful minority which wanted more reflation. The CBI had got about half of what it asked for. However, it had in practice turned out to be quite a "restrictionary" budget. The Treasury now accepted the CBI's forecast of 1% growth over the year rather than it own optimistic forecast at the time of the budget.

CBI trend reports over the last four months covering more than half manufacturing industry suggested that output and demand were going to be very flat. The June survey covered the 4 months through to October and this showed that activity would be flat for the first three quarters of this year. This was not conjecture but rather information obtained from companies' purchasing schedules.

How flat is very?
A classical Beckettism

If predicted growth of 1% did not in fact materialise unemployment would rise to $1\frac{1}{4}$ million at the turn of the year. There was evidence from his members that firms were backing off planned investment. Companies such as Tube Investments and GKN were again looking for further manpower cuts. ICI's problems over Wilton were well known. They were under extreme pressure and were not competitive. British Airways would have to take out more jobs. BSC faced well known problems in its US market. Leaders of the motor industry were telling him that there might not a British motor industry at all in five years time.

In spite of those gloomy indications, he was disinclined to change his view that activity would be flat or would rise by 1% this year. However, it was clear that there were big downside risks and few corresponding opportunities. The world scene was bleak.

He was about to go back to the CBI council to see whether the CBI's main budget proposals should be put again to the government. He stressed that his wish was not to increase demand but rather to help businesses to get there costs down. They needed more help in doing this. Also current expenditure needed to be reduced and investment expenditure increased. They were continuing to look at ways in which this could be done. [He also referred to his published letter to the Chief Secretary on pay, public spending and use of the contingency fund: the letter was distributed in the form of a press release at the meeting].

In answer to Mr Dorrell, who drew attention to signs of increasing import penetration, Sir Terence said that he had always believed this would happen. That was why he resisted pressure to increase demand. A small amount of extra demand was acceptable, but not much more. We must not go the way of France. A lower exchange rate would help a little. The risks of a lower exchange to inflation were exaggerated. The Treasury however would not quite agree. Low commodity prices and the green pound mechanism

reduced in practice some of the disadvantages of a lower exchange rate. We were still 35% less competitive than we were in 1975. There should also be another cut in NIS.

In answer to Mr Foreman, Sir Terence said that it was not just manufacturing but retailing which was flat. He agreed that higher public spending on capital projects in practice had revenue spending implications: but these were not too significant. Within public expenditure, it was important to cut pay, pensions and manpower.

Mr Budgen agreed with the CBI that interest rates needed to fall substantially. The CBI should argue this for money supply reasons. The Treasury appeared instead to be more interested in the exchange rate. The CBI also, he felt, needed a more distinctive view about energy prices. High energy prices were damaging industry and would do so over the long term.

In answer, Sir Terence said that the government had done a great deal on energy prices in the recent budget and something in the previous one. Our energy prices now were broadly competitive with those of Europe. However, it was not reasonable to expect successive Chancellors to introduce measures of this sort year in year out. Therefore, further action in the "middle distance" would be necessary. His feeling was that the use of an implicit exchange rate policy by the government was only a step in the procedure of keeping inflation down. Both the Prime Minister and the Chancellor had emphasised that there was no exchange rate target.

Mr M Stevens thought that the picture painted by Sir Terence, while applying to large firms, under-rated the progress made by small firms. Hammersmith and Fulham Chamber of Commerce were, for example, a few months ago, optimistic.

Sir Terence, however, said that the CBI had a Small Firms Council and listened to them. Moreover the manufacturing trends survey did reflect a fair balance of industry. He emphasised that he took no delight in recording "flatness".

In answer to Mr John Osborn , Sir Terence said that he strongly agreed with a recent Economist article showing how the government had been playing into Scargill's hand by subsidising conversion to coal. It was also dangerous that the wage negotiations dates in the coal industry had been brought forward from the Spring to November.

In answer to Mr John Page, Sir Terence said that the Japanese constituted a valid exception to the desirability of free trade, because of their "lazer beam" approach and the fact that they were not prepared to import our goods.

Mr Peyton said that the small firms in his constituency confirmed Sir Terence's view that activity was flat and were very gloomy. Interest rates would need to come down and stay down to give them confidence. There was also no proper industrial strategy and one was needed.

Sir Terence agreed. Ministers did not understand that when he called for an industrial strategy he did not want detailed invention. If we had had such a strategy we would, for example, like France have sufficiently invested in nuclear energy and so avoided many present problems.

Mr John Browne said that one area in which the government had to give a lead through industrial strategy was in videotext.

Sir Terence said that the government must redouble its efforts to gain the understanding by the United States of what was at

stake if its present policies continued. It could be ruin for the world. We should try and separate ourselves from the US more. We could sacrifice a little on the exchange rate to do so. We now have the money supply and PSBR under control. But the real rate of interest was going up as inflation fell.

Mr Wolfson agreed that an industrial strategy was needed.

Sir Terence said that one was generally being attempted, most notably in the Information Technology field.

Mr R Howell thought that the CBI should do more to condemn overmanning in the public sector in general and the Health Service in particular. Sir Terence agreed and said that the burden of the public sector had in fact greatly increased while the strength of industry supporting it had decreased.

RH

ROBIN HARRIS
14 July 1982

And so that you may know that my remarks are based on fact, perhaps I should add that in one garage business controlled by the Hodge Group there was an annual contract to take 350 Fords. The franchise was cancelled for the reasons I have given, so British Leyland vehicles were taken at the same annual rate. Then the British Leyland retail dealership was cancelled, so the garage was left high and dry with an empty showroom which was promptly snapped up by Datsun, who gave it an annual contract for 850 vehicles.

I told Sam Toy at the time, all those years ago, that their policy was mad, and I have had the dismal satisfaction of reminding him recently that the chickens have come home to roost.

What they did at the time might have been to the advantage of the Main Ford Dealers and the Main British Leyland Dealers, but for the country as a whole is has been disastrous.

To sum up, all I am suggesting in this somewhat lengthy letter is that in the event of there being any relaxation in hire purchase controls the relaxation should not be extended to used vehicles of foreign manufacture.

I do hope you may find these comments relating to the historical side of the retail motor trade of some interest.

Yours sincerely,

Julian Hodge.

CHAIRMAN
THE CARLYLE TRUST LIMITED

29/7 COVERING CONFIDENTIAL

cc Sir D Wass
Sir A. Goldman

BRITISH EMBASSY
3100 Massachusetts Avenue, NW
WASHINGTON, DC 20008

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26 July 1982

Clerks: please give the letter the usual ~~restricted~~ - circulation. Then normal, transient.
JMW. 29/vii

J O Kerr Esq
Principal Private Secretary
to the Chancellor of the Exchequer
HM Treasury

Dear John,

I enclose a letter which, as usual, is intended for the personal use of the Chancellor and senior UK officials.

I look forward to seeing you in Toronto.

Yours ever,

John

(J Anson)

Enc: 1

Pl. distribute v. urgently.
Actn. Mr Monck.
but cc. Mr Lovell + Co.
- Recd @ No. 11
- Ackn

From the Director General

Motor Agents Association
In Association with the Scottish Motor Trade Association
201 Great Portland Street
London W1N 6AB
Telephone 01·580·9122
Telex 261962

AMD/H290/DO

15 July 1982

Sir D Wass
Sir K Couzens
Mr Middleton
Mr Quinlan
Mr Kemp
Mr Lovell
Mr Turnbull
Mr Pirie
Mr Hall
Mr Ridley

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The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
The Treasury
11 Downing Street
London SW1

Dear Chancellor,

"....the situation is becoming desperate - used car stocks have reached an all time high - we must have action quickly...." These are the words of a Ford main dealer which reflect the feelings of thousands of very worried motor traders whose businesses are struggling against the anachronistic restraints of the Hire Purchase and Credit Sales Agreements (Control) Order 1976 introduced by your predecessor.

The government has abolished pay and price controls, dividend controls and foreign exchange controls and our economy has not collapsed. The Crowther Report urged the abolition of credit controls. It said that these regulations did not limit credit - they merely changed the pattern of consumer spending by diverting it from controlled goods to non-controlled goods and services.

Stocks of used cars held by motor traders are at record high levels and are not moving. Many prospective first time buyers for whom public transport is often inadequate for such basic and essential tasks as getting them to and from work, are prevented from buying a used car by the need to find a deposit of 33 1/3rd per cent in times of severe but necessary wage restraint. Yet for many a car is as basic a household requirement in today's world as a refrigerator, even more so. The anomalous requirement to save for what is often a prohibitively high deposit militates against people's willingness to accept wage restraint.

Last year we argued for a reduction in the minimum deposit required and an extension of the maximum repayment period. We are not repeating that plea. Events have gone too far for such steps to provide the level of relief so desperately

Motor Agents Association Ltd
Registered Office
201 Great Portland Street
London W1N 6AB
Registered in England Number 133095

The Rt Hon [illegible]
Chancellor of the Exchequer
The Treasury
[illegible]
London SW1

Dear [illegible],

[illegible] have [illegible] – we must [illegible]. These are the words of a Ford main dealer which reflect the feelings of thousands of very worried motor traders whose businesses [illegible] against the [illegible] of [illegible] (Control) Order 1976 [illegible] businesses.

[illegible]

[illegible] from [illegible]

[illegible]

required. For cars, the controls must be abolished.

Cars purchased by business users have already been freed from the restrictions but the vast majority of used cars are bought by private persons. Used cars are lying idle in great quantity waiting to be bought. They are having to be financed on dealers' premises by financial institutions. Abolishing the controls and permitting private persons more easily to enter into hire purchase agreements will not increase the total volume of credit - it will merely switch it from traders to customers.

Whilst the need for abolition is greater for used cars, it is not practical to differentiate between new and used cars because of problems of definition and the abuses that could arise from such differentiation.

We do not believe that prices would increase as a result of the abolition of controls as apart from the large stocks of used cars, there are ample supplies of most British-made new cars. Furthermore, in the retail motor cycle market, where there are no credit controls, prices are intensely competitive. In fact, retail prices of motor cycles are entirely comparable to used cars.

Motor traders, whether they be franchised by manufacturers to sell new cars or whether they sell only used cars, are mostly small businesses. Yet between them they employ more than 400,000 people, which is as many as are employed in direct motor manufacturing. Unlike some of the manufacturers, however, the retail trade does not enjoy any form of state assistance.

The motor trade's desperate measures to move stock by foregoing the major part, or all, of its retail margin have been widely publicised in the press. Not surprisingly, 13 per cent of all companies which went into liquidation in the first half of 1982 were in the motor industry.

Growing unemployment in those that remain is adding to the job losses caused by insolvencies and a major tragedy is the total inability of companies in today's economic climate to take on and train apprentices.

Many of our members' problems are the result of economic recession. To allow these problems to be exacerbated and bankruptcies increased by unnecessary restriction which it lies within the government' power to remedy is political and economic folly which we urge you to avoid by abolishing the controls now.

With kind regards.
Yours sincerely,

Alan Dix

Alan M Dix

required. For this, the controls must be abolished.

Over hundreds of thousands users have already been freed from the motor vehicle [illegible] of used cars are bought by private persons. [illegible] are [illegible] in [illegible] [illegible] they are hardly [illegible] the [illegible] controls practised by financial institutions. Additionally [illegible] abolishing private persons more easily to [illegible] [illegible] will not increase the total volume of credit - it will merely switch it from traders to the public.

Whilst the need for [illegible] is [illegible] greatest for used cars, it is not practical to differentiate between new and used cars because of problems of [illegible] and the chance that used [illegible] [illegible].

We do not believe that prices would increase as a result of the abolition of controls as, apart from the large stocks of used cars, there are ample supplies of most British-made new cars. Furthermore, in the retail motor cycle market, where there are no credit controls, prices are extremely competitive. In fact, retail prices of motor cycles are currently comparable to used cars.

Motor traders, whether they be franchised by manufacturers to sell new cars or whether they sell only used cars, are mostly small businesses. Yet between them they employ more than 400,000 people, which is as many as are employed in direct motor manufacturing. Unlike those of the manufacturers, however, the retail trade does not enjoy any form of state assistance.

The retail trade's desperate measures to move stock by forgoing the major part, if not all, of its retail margin have been widely publicised in the press. Not surprisingly, 13 per cent of all companies which went into liquidation in the first half of 1980 were in the motor industry.

How do these losses [illegible] is adding to the job losses caused by insolvencies and [illegible] [illegible] is the total [illegible] of companies [illegible] economic effects of [illegible].

They are [illegible] the result of economic [illegible]. [illegible] banking [illegible] by [illegible] and [illegible] the controls.

[illegible]

Alan M Dix

~~UNITED KINGDOM TREASURY AND SUPPLY DELEGATION~~
BRITISH EMBASSY
WASHINGTON, D.C. 20008

23 July 1982

The Rt Hon. Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury

Dear Chancellor,

Since I wrote to you on 19 March, we sent a general round-up of the US political and economic scene (in Washington telegram 1602) before the Helsinki meeting. You may like to have a further update before the summer holiday and the next round of meetings.

2. After several abortive attempts, the Congress succeeded in late June (a month behind schedule) in adopting an agreed Budget Resolution setting expenditure and revenue totals for Fiscal Year '83. But the budget deficit which appears in the Resolution - $104 billion - was too high to engender much confidence that the Administration and Congress have yet solved the problem of setting the deficit on a declining path. The Resolution is still based on quite optimistic assumptions about the economy, and it still has to be translated into a detailed budget for FY83.

3. While the Senate Budget Committee has now identified measures to obtain the necessary $21 billion in tax increases, these are highly fragmented and at risk from various special interest groups. More difficult problems remain on the expenditure side. Not all of the assumed savings are covered by specific instructions to the relevant Committees to find the savings by 1 August; and even where they are, some Committees are unwilling to comply.

4. The ponderous Congressional budget procedure therefore still has a long way to go before even the budget approved in June can be regarded as assured. Even then, the total Treasury borrowing requirement will impose a heavy burden on the financial markets during FY83. If on the other hand, Congress fail to give concrete legislative expression to the Budget Resolution before they depart for the election, the proposed tax increases would be lost, while the entitlement programmes would continue to grow. The effectiveness of the present budgetary procedures in setting and achieving a satisfactory budgetary path would again be called in question. In this event, the Administration and Congress would each try to shift the blame to the other; and partly for this reason, Congress is likely to make completion of the FY83 budget its main objective in the time that remains.

/ 5.

5. Even for the present fiscal year, which only has 2½ months left to run, there have been problems. The Congress agreed to raise the federal debt limit, thus giving up its most potent lever over the Administration this summer. But it has taken 3 attempts to find a supplemental budget which could be agreed by the Senate and the House and approved by the President. Without this, some government agencies would have had to put staff on furlough for lack of funds.

6. Meanwhile, the economy remains sluggish. The recession has probably bottomed out, but there are no convincing signs of a recovery. The Commerce Department's estimate of GNP is up slightly in the second quarter, and the index of leading indicators has risen in three successive months. On the other hand, industrial production continued to decline in May; and retail sales, which had been turning up, have fallen in June (mostly due to lower sales of cars).

7. Inflation was 6.7% in the year to June, and industrial earnings are rising at an annual rate of 6.5%, roughly static in real terms. Unemployment was 9.5% in May and June, and no early relief is in sight. Unemployment among black teenagers has now topped the 50% mark. The Republicans hope that the tax cut and social security increase, both effective from 1 July, will provide some stimulus - at least to consumption if not yet to investment. If it does not, they will obviously be in serious trouble in the polls in November. Many private forecasters are more pessimistic than the Administration, and feel that even if there is a temporary improvement in the second half of the year, it will peter out in the first half of 1983.

8. On monetary policy, Paul Volcker has just made his mid-year report to the Congress. The Fed is retaining its target for 1982 of a 2½-5½% range for M1; but it will regard an outcome around the top end of the range as fully acceptable, and will be prepared to tolerate temporary surges above the upper limit if these seem justified on technical grounds. For 1983, they are tentatively setting the same targets, and not marking them down a notch as might have been anticipated. They have been careful not to change this year's target figures, on the grounds that a large change would not be justified, while a small change would represent unduly "fine tuning" and could be misinterpreted by the markets as a change of policy direction. This adds up to a very moderate move towards a less restrictive monetary stance at a time when the pressures on the Fed are obviously mounting.

9. In the last month or two the Administration seem to have shown less tendency to pass blame over to the Fed for the high real level of interest rates and the sluggish economy. The Fed, in its turn, has held out an olive branch by agreeing in principle to base its /reserve

reserve requirements on current data instead of on data of two weeks previously. Opinions differ on how much difference this technical change will make in practice, but as some Administration officials strongly believed that the previous practice produced volatility in the money markets, the Fed's willingness to make the change may help to improve relations between them. However, the change is not to be introduced until May 1983. More importantly, Volcker's term as Chairman is due to end in August 1983; there are no indications yet of the Administration's intentions about his successor.

10. Conditions in the financial markets have recently eased somewhat, partly on account of Fed action to accommodate the aftermath of the recent failures of Drysdale Government Securities and of the Penn Square Bank of Oklahoma, both of which have got considerable publicity. Failures among the thousands of banks in this country are in fact not so uncommon. In the past few years, the number of failures of banks insured by the Federal Deposit Insurance Corporation has averaged about 10 a year. Deposits in insured banks are guaranteed up to $100,000, and normally the FDIC uses its guarantee funds to facilitate a merger with another bank. Penn Square seems to have been seriously mismanaged and subject to a large number of civil lawsuits, and to have concentrated its very rapid expansion too exclusively in risky oil development projects. The FDIC could not therefore find a willing partner in the time available and had to put it into liquidation. Given the existence of these insurance arrangements, the failure of Penn Square itself is containable. Its worrying feature is more that it highlighted the extent to which some of the bigger banks, such as Chase Manhattan and Continental Illinois, had been prepared to take over doubtful loans without adequate investigation. This will not be helpful coming on top of other worries about the extent to which US and Canadian banks are exposed in their lending both to overseas governments and to industrial and real estate businesses squeezed by the continuing recession.

11. The feeling in New York at present seems to be that interest rates could ease further in the short term. One bank I called on today had been wondering recently whether, in the light of recent movements, the Fed discount rate would come down by ½% or a full point. Now that it has come down by ½%, they are waiting to see whether "the other shoe will drop". But this belief goes with an assumption that the recovery will be slow to materialise. The continuing high interest rates at the long end of the market demonstrate that the good performance on inflation so far has not yet eradicated more deep-seated expectations that prices and interest rates could go up again when a recovery eventually comes.

/12.

12. Returning to the broader Washington scene, there are a number of proposals floating about for more fundamental budgetary reform. The proposed constitutional amendment for a balanced budget will soon come to a vote in Congress and, with Presidential backing, its prospects of being sent to the States for ratification look quite good. The irony of the President and Congress espousing this cause when agreeing on a record deficit for FY83 has not been / lost on the media (exemplified by the enclosed cartoon). To become effective, a constitutional amendment has to be adopted within 7 years by the legislatures of three-quarters of the States. In the near term, it can therefore be little more than a statement of good intentions. The effect of the amendment would be to require balance except in time of war or if a 60% majority of both Houses decide otherwise. In practice, it would thus only have a limited capacity to curb the deficit in any year when there is a political consensus that a budget balance is impracticable. Congress of course already has the power, if it chooses to exercise it, to control the federal debt ceiling.

13. There has also been some public discussion of the idea of substituting a flat-rate personal income tax for the present progressive tax with its complex system of deductions. The aim would be, by eliminating the deductions, to set a flat-rate tax at a much lower rate and thus accentuate the incentive effects of the Reagan tax cuts. The general reaction has been that, while simplification is certainly desirable, it is doubtful whether Congress would be prepared to tackle some of the more politically sensitive deductions, e.g. that for mortgage interest (which here is still unlimited). There is of course no time for any such legislation this year. Whether it will be seriously pursued next year will depend on the tone of the intervening Congressional elections.

14. Another major issue which will now have to await the next Congress is the restructuring of the social security system. Some changes will be necessary to assure its continued solvency, but this thorny topic will not now be considered until the report of a Commission is available at the end of the year. Whether the Administration will then have the courage to modify future benefits, along the lines of the proposals which occasioned Reagan's first major defeat last year, is often cited as an acid test of its determination to achieve a progressive reduction in the federal borrowing requirement.

15. The appointment of George Shultz as Secretary of State has of course stirred up questions whether he will play some (unspecified) rôle in economic affairs, and also whether there might be an economic overlord of the kind that Shultz was as Treasury Secretary. So far, this seems to have been mainly journalistic speculation. Shultz is likely to have his hands full as Secretary of State, but

/will

will no doubt take a particular interest in international economic matters, on which a new inter-agency group has just been set up with Regan as Chairman and Shultz as Vice-Chairman. On the second point there is no evidence that Reagan wants any economic overlord other than himself. In spite of his early protestations that he intended to introduce real Cabinet government, decisions still seem to be concentrated in the White House. Perhaps for this reason, the Administration seems to be finding it difficult to keep people in some of the key economic jobs. Those who have resigned, or are reported as intending to do so, include two of the three members of the Council of Economic Advisers (the Chairman, Murray Weidenbaum, and the monetarist Jerry Jordan); the two leading supply-siders at the Treasury (Ture and Roberts); the two top economic officials at State (Rashish and Hormats); and Anderson at the White House. Regan and Stockman remain, but Stockman has faded very much into the background. It is the Congressional leaders, particularly Republican Senators like Domenici and Dole, who have attracted more attention in the last couple of months since the President's own budget was formally rejected, and the initiative in producing an alternative has passed to the Congress.

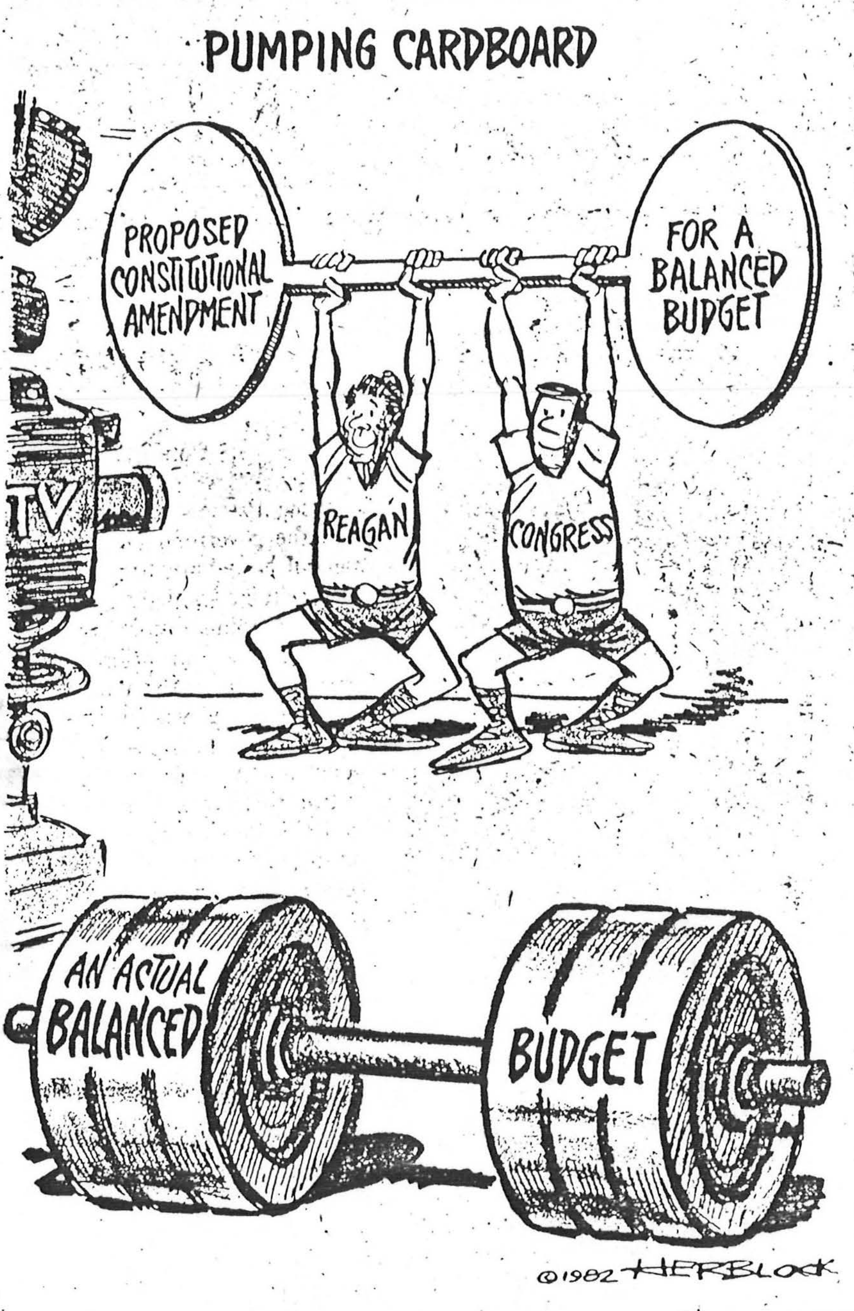
Yours sincerely,

John Anson

(J Anson)

Enc: Cartoon.

JULY 13, 1982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PROPOSED CONSTITUTIONAL AMENDMENT
FOR A BALANCED BUDGET
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MST(R)
Sir D Wass
Mr Middleton
Mr Kemp
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Record @ No. 11 urgent reply

/JP
PERSONAL

23rd July, 1982.

The Rt. Hon. Sir Geoffrey Howe, QC., MP.,
Chancellor of the Exchequer,
11, Downing Street,
LONDON. SW1.

Dear Sir Geoffrey,

FINANCE HOUSES ASSOCIATION

I am sorry to burden you with a copy of my long letter to you of April 13th 1981, but as I did not get an acknowledgement I have always wondered whether in point of fact you ever received it.

Don't think so

I am prompted in this action now by the references in the newspapers to the representations that are being made in respect of a relaxation of H.P. controls, but more especially by the fact that I have seen it announced recently that British Leyland propose to contract their dealerships still further, leaving more showrooms available for the introduction of foreign makes.

Perhaps I should add that in our Group we are the Main Dealers for Mercedes in Cardiff, so that the proposals I have in mind wouldn't exactly be in my own interests. I know that the proposals I have made probably offend GATT, but have the Japanese ever worried about that when planning their invasion of the European market.

With apologies for bothering you.

Yours sincerely,

Julian Hodge

THE CARLYLE TRUST LIMITED
CHAIRMAN

# The Carlyle Trust Limited

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/CRS
**PERSONAL**

23rd July, 1982

The Rt. Hon. Sir Geoffrey Howe, QC., MP.,
Chancellor of the Exchequer,
11 Downing Street,
London.
S.W.1.

Dear Sir Geoffrey,

**FINANCE HOUSES ASSOCIATION**

In the annual report of the Finance Houses Association, published recently, reference was made to the desirability of there being some relaxation in H.P. controls with a view to stimulating the motor market, which is now in a desperately tired condition.

This reminded me of an idea, that I advanced some time ago, for combating the mounting menace of the foreign penetration of our motor market. The possibility of this penetration continuing to rise well above 50% positively alarms me.

Ironically enough, to no small extent, the sale of foreign cars has been helped enormously through the foolish policy adopted by British Motor Manufacturers in the past. I suggest that without a knowledge of this early history it is not possible to appreciate fully why foreign manufacturers were so successful, nor indeed why we actually helped them to that success.

Some years ago the Ford Motor Company decided to concentrate all retail sales through their main dealers, and accordingly they cancelled retail dealerships that were within a radius of five miles of the main dealerships themselves.

This policy, dictated from Detroit, was really quite unsuitable for the U.K. market. Moreover, it threatened to put out of business many good retail proprietors who had established fine showrooms in prominent positions.

The retail dealers who found their Ford Agencies cancelled in this way moved over to British Leyland products wherever possible. But British Leyland ran into general management problems, and in an effort to strengthen their organisation recruited a number of Executives from the Ford Motor Company.

These gentlemen, I think, felt that what was good for the Ford Motor Company ( and it seemed good at the time), would also be good for British Leyland, so the latter then introduced the same policy and followed the Ford Motor Company in cancelling its own retail dealerships within a radius of five miles of their main dealers.

In desperation these abandoned retail dealerships turned to foreign manufacturers, who found the doors wide open, with splendid representation readily available in many prominent situations in almost every town and city in Great Britain. Had it not been for the policy pursued by Ford, and then by British Leyland, the foreign manufacturers would have found their sales and penetration problems much more difficult.

As it was, the facilities for attacking the British market were there ready and waiting, with the owners of those facilities anxious only for their own survival.

Accordingly, it has occurred to me that if <u>any relaxation</u> of hire purchase controls excluded used vehicles of foreign manufacture, the attractiveness ( for example) of a Japanese car would disappear overnight, as the part exchange value would fall dramatically. As it is, there is a growing tendency for private motorists to move over to foreign manufacturers because the cars are sometimes better made, more reliable, and even cheaper. Only when it comes to spare parts and repair work is it found that there is any disadvantage.

As the vast majority of used vehicles are purchased by way of hire purchase the absence of this facility in respect of foreign makes would cause their value to slump, and that slump in used vehicle prices would have a dramatic effect on the new vehicle sales of the foreign manufacturer.

Perhaps I should add here, that I have considerable past experience of hire purchase, having managed among other things ( before my retirement in 1978 from the Hodge Group ) the sixth largest Hire Purchase Company in Great Britain. In addition, my former organisation sold very substantial numbers of both British and foreign motor cars, also owning four Main Ford Dealerships and the British Leyland franchise for South Wales.

It seems to me that my simple idea, and it may be too simple of course, would effectively control imports without the imposition of any kind of import control at all.

Certainly, if any relaxation of hire purchase controls specifically excluded used foreign makes - <u>from the relaxation itself</u> - it would be of tremendous help to British manufacturers.

. . . . Cont'd.3.

FROM: E P KEMP
26 July 1982

pwp

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir Douglas Wass
Mr Burns
Mr Middleton
Mr Quinlan
Mr Dixon
Mr Allen
Mr Monaghan
Mr Norgrove
Mr Ridley
Mr Harris

YOUR SPEECH FOR TOMORROW

Here is a revised version based on indications which Mr Kerr gave me this morning.

2. One or two points. First, we have available a more detailed description of current SEMs if you want to include it (paragraph 33). Second, we are thinking of how best we could demonstrate what £350 million - 1 per cent of the public sector wage bill - might buy, and how best to give force to this point (paragraph 46). Third, there is no discussion in the present draft about cost of unemployment, though I would specifically draw your attention to paragraph 37 and 39 which by referring to the net cost of measures implies that at any rate in these two particular cases we do know the difference between net and gross. Fourth, there is no mention as such of the Layard scheme, though we have available three paragraphs if needed - however it might be better to leave this to Mr Tebbit to deal with on winding up if it is raised in the course of debate. Fifth, we could have a paragraph available on the Atlantic Conveyor, but this I undertand depends on the matter actually being satisfactorily settled before tomorrow afternoon, as well as on whether or not you want to mention it. Finally, we could not find a place in this draft for Mr Kitcatt's piece on local authority capital underspend (as revised by the Chief Secretary) but it may anyway be best to omit it.

3. I have left the conclusion to the speech as they were drafted for the Friday version; you will want to consider this yourself.

4. Mr Norgrove has put to you separately an updated set of general briefs, including a note on the cost of unemployment, a note on the PSBR undershoot, and a note on Sam Brittan.

5. Mr Norgrove is putting to you a form of words for a Government amendment to the Opposition Motion, which we have agreed at official level with Department of Employment. The main question you will want to consider, however, is whether you want to put down an amendment at all or whether you just seek to get the Motion defeated.

EPK

E P KEMP

CHANCELLOR'S OPENING SPEECH CENSURE DEBATE
TUESDAY 27 JULY

## Part 1 - Introduction

[ General scene setting, if any - possibly refer to $4\frac{1}{2}$ months since Budget, alarms and excursions elsewhere - Falklands, Security, terrorism, etc. ]

2. Glad to turn to the economy. But sad because main trigger for debate are last week's unemployment figures. Agree whole heartedly about seriousness of problem. No difference of opinion in House on that.

Part 2 - Unemployment

3. Facts clear enough. Cannot pretend this is a problem that has just arrived. Been on upward trend for last 25 years. Average around 300,000 1950s and early 1960s, 500,000 in late 1960s, 800,000 in 1972 and 1.4 million in 1979. Now 3.2 million.

4. Causes. Statement of the obvious, unemployment arises because no one wants to buy the goods the employed person used to produce. Called competitiveness. Why has competitiveness declined?

5. Well documented; inflexible adherence to outdated and usually restrictive practices by both management and unions and blind to need to make necessary change. Led to overmanning - so-called "hidden unemployment" - where no real job existed but things appeared all right and management and unions reluctant to make painful but necessary changes. Same thing on a larger scale went for successive Governments; well-meaning efforts to deal with problem were merely tinkering; just put off the evil day and were ultimately counter-productive. Notable example of this in steel industry.

6. And over and above all this, excessive pay rises. Paid ourselves amounts unjustified by productivity improvement, or the real worth in the customers eye, of what was being produced. Between 1970 and 1980 money demand increased by more than 300 per cent, but real output by only 1/20th of that amount. Individual people in work may have thought they were better off - indeed were better off personally, at least for a time, unless the workers' own job was threatened, as was often the case.

7. Result; loss of markets overseas and increased import penetration. Inevitably the case when major overseas competitors are more efficient and cheaper than we are. So people stopped wanting to buy our goods, so our goods stopped being made, so unemployment went up.

8. Repeat, been going on for a long time. Not fault of any single Government. Would have hoped that RHM would recognise this. After all, it was the Chancellor of his Government who coined the phrase "confetti money".

Part 3 - Basic prescriptions

9. Follows that if we are to get people back to work must recapture markets so that people, home and abroad, want to buy things we can make in preference to buying them from somebody else. Not necessarily the case of recapturing old lost markets; should be opening up fresh areas, both geographically and product wise.

10. To do this, must improve competitiveness. This means lowered real costs. This means greater efficiency, greater productivity, and above all restraint in wage settlements.

11. This is necessary not just so that British goods produced can compete on price, but also so that industry's profitability can be restored - note $2\frac{1}{2}$ per cent in real terms in 1981 for non-North Sea companies compared with 11-12 per cent in mid-1960s.

12. We all need to promote new enterprises, and expand bridge-heads.

13. This needs control of inflation, lower interest rates and control on public spending so as to ease tax burden.

14. People still want to have something for nothing. Within responsible economic policies

can only have lower interest rates and lower

tax burden if public expenditure is curbed.

Yet people [RHG], CBI, and others want lower interest rates and lower tax <u>and</u> more public spending.

[ Wish they would tell us how to work the trick.]

[ Must have more mirrors than a fun fair.]

Part 4 - Overseas

15. Whole problem made very much worse by being tackled at the same time as the rest of the world is obliged to try to do the same thing. To some extent all major powers been experiencing difficulties - inflexible labour markets, failure to adjust to two great oil price shocks, and so on.

16. Other countries have their unemployment problems too. Unemployment rate in UK is 12½ per cent and of other major 7 OECD countries, about 10 per cent in Canada, France and Italy, close to that figure in USA. And in many other countries unemployment now rising more rapidly than here. In year to May, unemployment rose by over one-quarter in US and two-fifths in Germany and Canada, compared one-sixth here.

17. Now general consensus - OECD etc - about how to tackle problem. Responsible monetary and fiscal policies are required. And indeed mostly adopted; most other countries have not been trying to "solve" unemployment by reflation. According to OECD, about half have been cutting expenditure and a similar proportion have raised taxes; some have done both. Germany and Netherlands public expenditure and borrowing cut, and these countries like UK

now enjoying falling inflation and healthy balance of payments and current account suprlus. In the United States see what happened where necessary measures not yet satisfactorily taken; inflation performance good but interest rates still very high because of the fiscal deficit.

18. Most striking of all, France. Enthusiastic socialist Government goes for reflation. And then has to see the light. French Government now introduced package of austerity measures including shelving of many public expenditure prospects, a four-month prices and wages freeze, and cuts in planned spending on social security benefits. Foretaste of what we would see here if some of RHG's proposals implemented.

19. All this buttresses our own analysis. Our policies in line with international consensus and individual case studies show international consensus right.

Part 5 - Where are we going?

20. Signs of gradual recovery in the economy. Industrial production three months to May 3 per cent higher than underlying level in Spring of 1981. 1 per cent rise in production in May may be first indication that hesitation has come to an end. Longer leading indicators rising strongly. Most outside forecasters look for growth of 1 to 1½ per cent this year and 2 to 2½ per cent in 1983. Of course uncertainties, notably in world economy. But more encouraging news from US recently.

21. Sources of recovery. Much of growth in output since Spring 1981 has from turn-round in destocking. But also fixed investment up by 4 per cent between Q4 of last year and Q1 of this year. DOI investment intentions survey point to 2 per cent rise in manufacturing, distribution and services investment this year and more next. Private sector investment particularly in plant and machinery has been holding up well - last year latter was some 8 per cent higher than the first half of 1979. Housing starts in 3 months to May 1982 42 per cent higher than in same 3 months 1981. Over same period, orders for new construction work rose 11 per cent.

22. Exports held up well given loss of competitiveness between 1975 and beginning 1981. In last 9 months non-oil exports, excluding erratics, above their level in 1980. Trade with newly industrialised countries particularly buoyant (reference back to remarks about enterprise and finding new markets). Of all countries we had in 1980 second largest balance on invisible trade, behind only US. We increased our lead over US as largest net earner in field of financial and agency services, consultancy and insurance.

23. Manufacturing productivity - output per head - 12 per cent higher than at the end of 1980 and 5 per cent higher than at previous peak of activity in first half of 1979. Examples in the motor industry - Fords have continental standards of efficiency at Bridgend, BL has improved overall productivity by over 50 per cent in last 2 years and Metro line approaches Japanese performance.

24. Pay. Because manufacturing pay settlements have come down, and productivity has risen unit wage and salary costs have risen only 3 per cent in last year, well below average of major competitors and comparable with Japan and Germany. Cost competitiveness ......

improved 10 to 15 per cent in last 18 months. Industrial profits begun to recover in 1981 H2, though improvement from a very low base.

25. Interest rates. Been reduced substantially this year. Much of the time this was against the tide in America, but even so while at the start of the year our rates were 2 per cent above those abroad, earlier this month they were 3 per cent below. And tide in US now turning in our favour.

26. Finally inflation. Economic as well as social malaise. No way in which high inflation can live with job recovery. Success here; last autumn forecast inflation by the end of this by 10 per cent; at time of Budget revised downwards to 9 per cent with 7½ per cent by middle of nextyear. Now see very good chance of 7½ per cent by end of this year. With exception of single month in 1978 represents lowest figure we have seen for a decade.

27. Hope House and RHG recognise all these signs. None so blind as will not see. Perhaps does not suit them to see. But signs are there.

Part 6 - Steady overall policies

28. These signs of recovery, turning round 20 years backlog, direct result of steady economic policies. These designed to bring about falls in inflation and interest rates which are so necessary to business confidence. "Steady macro-economic policies" not end in themselves. Policies are there for what they bring about. And they are bringing out whats needed; lower inflation, lower interest rates, and, as at time of last Budget, real tax cuts which were then aimed specifically to help business and jobs. [This included £640 million worth help to business through a reduction the National Insurance Surcharge, a cut which comes into effect next week.] Steady fiscal etc policies not inconsistent with tax reductions aimed at helping businesses; rather, pre-condition for these.

~~or~~ or later? see paragraph 59

29. What does the Party opposite want? Look at "Labour's Programme 1982". No doubt will be carried with acclaim at Conference in September. But makes sad reading, both against experience in this country and overseas. The same old prescriptions - substantial reflationary programme financed by public sector borrowing, as though this is going to help unemployment in the long-run. It is not. Apart from

anything else it totally ignores the effects it would have on the exchange rate, interest rates, and inflation - and then where would the investment for the new jobs come from. There would be price and profit controls but not, be it noted, any policies of wage restraint. Sympathise with reluctance of Party opposite to go in for wage controls - do not want them ourselves. But without them this programme would simply lead to the sort of thing we have seen in the past, with huge growths in money income and no growth in output. No jobs lie that way at all. This is not just doctrine, it is proved by the experience of the past 20 years.

30. of course there are those who advocate less crude shifts in policy. These include the Chief Secretary's brother. Mr Sam Brittan has argued in favour of fiscal stimulus in part on the grounds that money GDP appears to be growing more slowly than expected. However would not myself want to put such weight on short-term movements in a measure like money GDP. For one thing, suspect it may be telling us more about what has happened in the past than what is likely to happen to prices and output in the future. Even if we had a money GDP target, do not think it would be sensible

to try to fine tune it, by adjusting policy every few months. True that money GDP has recently been growing a little more slowly than we expected, though think Sam Brittan exaggerates extent of the shortfall. But correct response depends on what has caused it, and whether it is likely to last.

31. Do not think that weaker growth in domestic demand is the only - or even the main reason. Guess that what we have seen is temporary hiccup. Firmly believe that falling interest rates will boost recovery, and give help where it is most needed - to companies and investment. But very much agree with Sam Brittan in one respect - very important to judge scope for any easing of policy within overall framework set out in Government's financial strategy. That provides financial discipline to maintain progress on inflation and create conditions for sustainable recovery in output and jobs. At the right time - not now - will be considering [eg CBI and ABCC] ideas for fiscal and other change. But will continue to do so against need to maintain framework.

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Part 7 - Special employment measures

32. Current policies paying off [repeat briefly from paragraphs 20 to 26 above on output, productivity, investment, interet, inflation etc.] Have already agreed however that high unemployment figure tragedy. Only way to get this down on a permanent sustainable basis is to continue with these policies now beginning to pay off. History and experience shows this as well as good sense. But does not mean Government can be blind to those who are hit by the process of change. Must do what we can to alleviate burden.

33. Wide range of special employment and training measures in hand. Cost £1½ billion per annum helping about ½ million people. [Expand?]. [To follow].

34. But is not all. In Budget Speech mentioned suggestion - raised by Lord Scarman amongst others - there could be advantage in bringing together in local communities tasks of environmental improvement or help to those in need that are crying out to be performed, with on the other hand some of those who are out of work. I said "there are people needing work and work that needs to be done; the need is to match the two".

35. MSC now put to RHF Secretary of State for Employment recommendations for the operation of such a scheme, which Government accept.

36. The Commission will accordingly introduce on 1 October a new Community Programme providing opportunities for community work and coluntary service for those who have been unemployed for some time. The community work part of this programme will bring together the existing Community Enterprise Programme and the Budget initiative to provide a much larger number of opportunities at a relatively low unit cost. If the demand is there, this will together provide up to 130,000 places for the long-term unemployed. Most of the places will be part-time and assistance will be given with training if required.

37. The new Community Programme will also encompass the scheme for voluntary service announced in May, and the whole programme will continue for at least 2 years at a gross cost in a full year of about £575 million including the existing measures. The net expenditure cost of the extra 100,000 Community Work places will be £185 million a year after allowing for savings on benefit payments; this figure, which includes supervision, is much in line

with the £150 million which I foreshadowed in the Budget and which did not include supervision costs. It will be found within existing planned totals.

38. The Government has also decided to encourage the extension of part-time work more generally in the economy. The object .....

will be to provide additional opportunities for productive jobs for unemployed people. We propose from 1 January next year until 31 March 1984 to offer grants to employers who split full-time jobs into part-time jobs. These grants will be pitched at a level designed to cover employers' costs and offer them an incentive to take part in the scheme. They will be paid in cases where the splitting of a job results directly or indirectly in a reduction in the number of unemployed people claiming benefit. This proposal is similar in principle to a suggestion made in the recent Report on Unemployment from a Select Committee in another place. The idea has also been under examination by the MSC, in a study to be published shortly.

39. Full details of the scheme will be announced in the early autumn. It is not possible to forecast what the effect will be in putting back to work people now unemployed. But if for example a payment of £500 were made and 100,000 jobs were split, 100,000 people would benefit and the gross cost would of the order of £55 million over the life of the scheme. Since

there would be savings from benefits that would otherwise be paid the scheme could have no net cost in terms of total public expenditure.

40. I hope the House will fully support these imaginative new measures. If people respond positively many of the long-term unemployed will be given an opportunity for undertaking useful work, to their own benefit and that of society.

Part 8 - Pay

41. Point to note about these two schemes I have just mentioned; illustrate benefit of lower pay. In simple terms, if pay is lower per place then there are more places to go around. Obvious, at this level, but obviously of wider application also.

42. Mentioned pay earlier as cause of unemployment. Repeat it; restraint in pay is the key to lower unit costs, to restoring profitability and making funds available for investment, to checking redundancies and lay-offs. Cannot repeat too often that there is only so much money to go found - real money, that is, that has been earned. And if some people take too much of it then others lose their jobs.

43. Pleased to see that this message taken to heart by Party opposite. They are offering staff a zero pay increase on grounds that Party's finance are in such a condition as to preclude any pay rise. So the staff of course decided to take industrial action. Hope that Opposition will stand as firmly behind other employers who resist irresponsible pay claims as they stand when they themselves are the employer.

44. Signs that pay rises are slowing down. Good thing. But a very long way to go. Average settlements in manufacturing in this country are still half as high again as those in Germany and Japan. Those who take the problem of unemployment seriously will settle for much smaller pay increases than in the last 12 months. In many cases ought to be no increase at all - notion that people are somehow entitled annually to more money, as of right, one of main causes of unemployment. Rises must be related to individual circumstances of company involvement; too much in this country are pay increases based on "keeping up with inflation" and bogus comparability. And rises must reflect need for improved profits so that new investment takes place; they must also be justified in terms of the production that can be sold, bearing in mind progress being made overseas.

45. What matters is the real worth, on the world scene, and in the customers eye, of what is being produced. No use being good, if someone else is better. Wage bargainers starting to recognise this, but a pity that so many jobs had to go first. Hope wage bargainers will go on recognising it, and also recognise what has just been said about price inflation coming down. Another reason for restraint.

48. Speak not just as Chancellor responsible for all economy but also man in charge of public spending. Public spending too high if we are to get interest and tax rates down. Pay bill in the public sector around £35 billion per annum. Each 1 per cent off annual increase worth about £350 million, or [some examples to come]. Government determined to resist unjustifiable pay increases in the public sector so as to keep down public spending and also set an example to other employers.

[Wise to mention NHS? Mr Fowler's view.]

49. Note British Rail position - glad people now back at work. Example of good sense shown by NUR rank and file, sorry ASLEF dragged on longer. Need now to recapture the markets threatened by the strike, so as to start to restore finances and to justify new capital investment. [NHS - Government good record on keeping up level of services. But must be threatened by current dispute. More pay per head means that a given sum goes round fewer heads - and this means redundancies in the Service and lowering of standards for the sick.]

Part 9 - Other Government action

58. Mentioned two fundamental requirements if unemployment to be beaten; steady fiscal and monetary policies and realism in pay. But Government taken steps in many other areas to try to meet the basic requirements if unemployment is to be beaten, mentioned earlier - encouragement of change, of enterprise, of new businesses, of restoration of profit margins, and so on.

59. Change. Lot done to bring about atmosphere for change. Swept away a whole raft of controls left by predecessors. Got rid of controls on prices, dividends, office development and industrial development because they inhibited enterprise and businesses. Got rid of exchange controls. And now got rid of hire purchase controls, last of the line. Look to British industry to take advantage of this. Still some controls left in local authority field but hope those can go, where they have outlived their usefulness, as soon as possible.

50. Active policies too. Enterprise zones. At present 11 zones and clear they are achieving impressive results. Range of development is underway bringing new enterprise, more jobs and much needed investment to old dockland

areas like the Clyde to steel closure areas like Corby and to other areas of physical delay. For example, since we announced the creation of enterprise zones at Clydebank over 100 firms have moved in - nearly 50 of them new firms - with potential for over 1,300 jobs. Private sector grasped the new opportunities and public authorities supported the initiative with enthusiasm.

51. Going to build on this. Announce today we intend to designate 10 more enterprise zones in similar type of area - 7 in England and 1 each in Scotland and Wales and Northern Ireland. The same attractive package of benefits will apply to these as to the first 11. RHF Secretary of State for Employment today issuing Press Notice.

52. It is hoped will attract new small business. And not just EZs. New small business needs to develop new ideas and create more jobs. No Government has done more to help. Hundred new measures since taking office to help small firms. Venture capital, Business Start-Up and Loan Guarantee Schemes. Increased rewards by reducing weight of taxation on them - lowering the rate of small companies' corporation tax. Eliminated or eased administrative burdens wherever possible.

| | |
|---|---|
| | 53. Particularly pleased with loan guarantee scheme. Last week results of survey laid before House. Indicate a success. Showed around 80 per cent of the loans would not have been made if scheme had not existed. And over 2,500 new businesses have already been created with the help of the scheme. Opinion is that pilot scheme is operating satisfactorily to meet objectives set for it and that it is having a real effect on attitudes of Bank Mangers and others who provide small firms finance. Generally regard this venture as a success, [though |
| To be checked with DOI | always room for some improvements and RHF Secretary of State for Industry will be making an announcement shortly.] |

54. With these initiatives would include privatisation programme. Nasty word but the right idea. No irrational prejudice against publicly owned industry. But many years of sad experience. Best incentive to increase efficiency in public sector is to introduce impact of market forces.

55. Why do we need efficiency in public sector? Answer obvious - very large part of the economy and must have assets properly used. Tariffs etc - nationalised industry

4. Particularly pleased with loan guarantee scheme. Last week results of survey laid before House. Indicate a success. Showed around 80 per cent of the loans would not have been made if scheme had not existed. And over 1,500 new businesses have already been created with the help of the scheme. Opinion is that pilot scheme is operating satisfactorily to meet objectives set for it and that it is having a real effect on attitudes of Bank Managers and others who provide small firms finance. Generally regard this venture as a success, though always room for some improvements and the Secretary of State for Industry will be making an announcement shortly.

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5. With these initiatives would include privatisation programme. Nasty word but the right idea. No irrational prejudice against publicly owned industry. But many years of bad experience. Best incentive to increase efficiency in public sector is to introduce impact of market forces.

6. Why do we need efficiency in public sector? Because obviously a very large part of the economy and must have greatly economy used. And the case - nationalised industry

and public sector charges very big burden on industry. Public expenditure demands - nationalised industry external finance for this year over £2½ billion. Enterprise and innovation - no doubt at all that private sector attitudes produce the best track record. Consumer choice - ensure that where possible privatisation will include competition, which must be good for all of us.

56. Done a lot here, and intend to do a lot more. Witness important statement last week by RHF Secretary of State for Industry about British Telecoms. Note Party opposite programme inevitably includes its dreary extension of nationalisation list and renationalisation of what we have sold. Hope the successful managers and employees in British Aerospace and National Freight Corporation, now thriving, take close note of this proposal.

57. Finally, restoring profitability. Look at last Budget. Following that interest rates and inflation down. Around £1 billion real reductions in taxation mostly to help businesses. Measures on enterprise, innovation, energy prices and construction.

All things industry wanted. And of course the cut in the NIS - cost £640 million this year - which comes into effect next week. In parenthesis, shall be watching carefully to see that this does go into profitability and not simply into meeting excessive wage demands. But all these measures were things designed to help jobs.

58. In summary, tackling problem at root. Not simply tinkering with short-lived fiscal and other measures. Seeking to bring about the long overdue change which will have this country adapt to the world we live in. Not easy, not painless, but long overdue and now very, very necessary. And country recognises this.

[As of previous version]

VIII. Conclusion

59 ~~61~~ ~~45~~. Mr Speaker, in four months time we shall have the usual autumn economic forecast and we shall want at that stage to review how things are going, and let the House have our views. Then we shall be on to the next Budget. As I said, In the last Budget I combined maintenance with steady economic policies with real tax reductions, mainly aimed at helping with jobs. It is too early to make any forecast for next year, but provided we stick to our policies the prospects for something similar are there.

60 ~~46~~. Unemployment is indeed a tragedy. Would there were some simple solutions. But there are not. We have to continue with our efforts to get the economy back on the right lines. Against an unfriendly world background, these efforts are beginning to pay off, albeit hesitantly. There is no reason now to depart from steady economic policies we have adopted - indeed the reverse is true in that to abandon them would be to abandon all our gains - on hopes for tax cuts, on inflation, and on output. And worst of all, whatever temporary affects it might have, it would be to abandon the prospects we have for a lastingly improved economy and a sustained reduction in unemployment.

Discussed at Wednesday's meetings (PWP.)

J

Pps will go in Fiscal Policy meeting folder

D.

JH

FINANCIAL SECRETARY TO THE TREASURY

FROM: D L WILLETTS
DATE: 26 July 1982

CHANCELLOR — 2

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Mr Middleton
Mr Monck
Mr D Moore
Mr Reed
Mr Ridley
Mr French
Mr Green - IR
Mr Phelps - C&E

BANK TAXATION

The Financial Secretary has seen the Economic Secretary's comment (Mr Harrison's minute 21 July) on Mr Middleton's submission to you of 20 July. The Financial Secretary would add that by next Spring having solvent UK banks may seem like a virtue instead of a vice - a welcome exception to world-wide trends which the Government will be pressed not to endanger.

DLW

D L WILLETTS
26 July 1982

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DATE: 26 July 1982

CHANCELLOR

cc Chief Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
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Mr Monck
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m Mr French
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26 July 1982

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Sir D Wass
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Mr Quinlan
Mr Middleton
Miss M. P. Brown
Mr Kemp
Mr Ridley

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury
Great George Street
LONDON SW1

27 July 1982

Dear Geoffrey,

RETAIL PRICES INDEX: ASSESSMENT OF THE RECENT TREND

You may know that my statisticians, in conjunction with yours and those of other main departments concerned, have been developing a supplementary series to the RPI to give an improved, additional guide to the recent trend position on prices compared with that provided by the percentage change on a year earlier. Officials, including Mr Terry Burns in your department and Sir John Boreham in the CSO, are agreed on the technical basis and the value of having the new measure as an additional guide to trends.

I am content with the technical basis of the new series, which it is proposed should be called "the recent adjusted trend". Details ... of its construction and some results are given in the enclosed note.

Whilst I support the internal use of the series, on a confidential basis, I see difficulties in envisaging publication. A major consideration is the risk of introducing confusion and uncertainty in the public mind as to what is the rate of inflation. In an area so sensitive and important nationally as this, one needs to be very wary of introducing an additional figure which might disturb and confuse the position. At present there is the well established measure provided by the percentage change over the previous twelve months which commands wide acceptance. Though it may not be ideal in all respects it has much to commend it, a year being a reasonable length of time over which to appraise price movements in a fairly stable fashion and to include within it price changes which tend to recur annually. The new measure, being shorter term, will in consequence be susceptible to greater fluctuations which the data show can be up to a few percentage points. It could well be taken as an alternative measure of inflation which could be misleading and cause confusion. It could also provide scope for negotiations in pay bargaining to appeal to a higher figure when it suited their purposes whilst reverting to the year on year figure when this was the higher; whilst price movements ought not to be a major determinant of pay settlements we have to recognise that in the world as it is they are still much used in seeking to influence negotiations.

SECRETARY OF STATE FOR EMPLOYMENT

I propose therefore that whilst the series may be used internally on a limited confidential basis we should not envisage it being published.

If you agree, I will then arrange for the new figures to be prepared each month, with the broad categories as shown in the note, and circulated to the limited group of ministers and senior officials who receive advance notification of the RPI.

RETAIL PRICES INDEX : ASSESSMENT OF THE RECENT TREND

NOTE BY DEPARTMENT OF EMPLOYMENT

Introduction and Summary

1. It has long been a problem to assess the current trend in retail prices. In the absence of anything better, this has been couched mainly in terms of the percentage change over the past twelve months. Although this figure is of very considerable value and of general interest as a measure of inflation, it can blur, or even conceal, within a period as long as twelve months a marked quickening or slowing down in the rate of change in prices. However, simply taking a shorter period of the RPI movement, for example over six months, is not satisfactory, because of large occasional price changes such as rent and rate increases in April and the seasonal tendency for prices to rise more in the first half year and less in the second. Accordingly a new, additional series, to supplement the RPI, partly involving the seasonal adjustment procedures used in many economic series, has been developed in the Department of Employment, in cooperation with other Departments. Called "the recent adjusted trend", it provides an improved indication of recent movements in retail prices. A description of the methods used is given later in this note.

Results

2. It is clear from the chart that the new series reflects changes in the trend of price increases much sooner than the conventional 12-monthly change in the retail prices index. When inflation is rising, as it was in 1976 and 1979, the adjusted trend runs ahead of the 12-monthly increase and shows higher figures. Then, as inflation begins to ease, as in 1977 and 1980, the adjusted trend reaches its peak and begins to fall sooner, with for some time lower figures than are shown by the 12-monthly rate. We have again been in this position during the early months of 1982. The adjusted trend does not necessarily predict the level subsequently shown by the percentage change on a year earlier; whether shorter term movements in the trend show up in the change over a year depends on how long they are sustained.

3. The behaviour of the individual components of the new series is also of very considerable interest. These are shown, together with the overall adjusted trend, for each month in recent years in the accompanying table. The decline which developed during the second half of 1980 in the overall rate of price increases was largely attributable to "mainly private sector goods and services" and expenditure tax changes, both of which fell back to single figure rates. By contrast, prices of nationalised industries, rents and rates were accelerating into the 20-30 per cent range. During 1981 these latter continued to show strong rates of increase. The main reason for a sustained reduction in the overall trend since late 1981 has been a considerable further slowing down in the rate of increase of what is mainly the private sector, assisted by some reductions in the contributions from rents and expenditure taxes.

Detailed description of methods

4. A number of influences and factors tend to obscure the assessment of the recent trend in retail prices. They have varying characteristics and require differing procedures for estimating and allowing for their effects. One factor is seasonal influences, similar to those commonly found in other economic time series. However, the standard seasonal adjustment techniques have proved inadequate when applied to the RPI as a whole. This is because certain important items, such as rents, rates and nationalised industry products, exhibit a pattern of change - often with a substantial increase once every twelve months with no movement in between - which is not susceptible to the normal seasonal adjustment procedures and for which special treatment is required. A further factor to be taken into account when assessing the trend is that a single month is much too short a period for this purpose. The underlying position only manifests itself over a period of months, with the sample of price changes coming through in individual months, and the size of those changes, a variable and uncertain guide to the trend.

5. In estimating the recent trend, it has been found that the constituents of the retail prices index can be divided into two groups:

(a) "special" items, consisting of nationalised industries' goods and services, rents, rates, mortgage interest rate changes, budget changes in duty and other expenditure taxes, and seasonal foods. Apart from the latter, these can be described as "mainly administered".

(b) all other items. These account for about 75 per cent of the index and can be described as "mainly private sector".

These groupings reflect the way their prices move and the associated method of smoothing for incorporation in the "recent adjusted trend".

6. Price changes in the mainly administered group of items exhibit several particular characteristics which cause the normal seasonal adjustment techniques to break down. Changes for most, but not all, of them, tend to occur at about the same time each year, but not necessarily precisely in the same month. Also the magnitude of the changes is liable to vary considerably from one year to the next. In general they have a disturbing effect on the month to month movements in the RPI. The solution adopted in deriving the adjusted trend for these items is to spread the price change over a year by taking one twelfth in the month when the change occurs and one twelfth in each of the following eleven months. This method has a similar objective to that of the standard

seasonal adjustment procedures, namely to spread the seasonal peaks evenly over a year. It also has the merit of simplicity and can be readily understood. . . is equivalent, when expressed at an annual rate, to taking the percentage change over a year earlier.

7. Having estimated the trend for special items in this way, it is not thought appropriate to apply any further smoothing. It sometimes happens that price changes for 'administered' items occur more frequently than once a year. It is proposed that these additional price changes should be treated in the same way as the main or usual increases by spreading in equal amounts over a year.

8. The group "seasonal foods" (fresh vegetables, fruit and fish; eggs; home-killed lamb) is also treated as a "special" item, because the variability of the seasonal fluctuations is too erratic in timing or size for the conventional seasonal adjustment techniques to be applied satisfactorily. Two adaptations have been made to the method for "special" items. A three monthly moving average of the index for seasonal food items is taken rather than the index for individual months, which are liable to be erratic. Secondly, the percentage change on a year earlier shown by these moving averages is taken as the adjusted trend (at an annual rate).

9. The residual group of all other items (mainly private sector) consists of many individual goods and services, the prices of which change in a variable pattern, at different times and by differing amounts. Taken together, however, there is a continuous gradual movement in prices, unlike the steps exhibited by the special items, and there is no need to treat any of them individually.

10. The movement of this group of prices taken as a whole shows perceptible seasonality, with increases tending to come through more strongly in the early months of the year and less so in the second half. Accordingly this composite series is seasonally adjusted using the standard techniques of the X-11 program developed by the US Bureau of the Census. Seasonal adjustment is applied to the changes, rather than the absolute levels, in the index; data back to 1970 have been used in the calculations.

11. After allowing for seasonality, the series for "all other items" still shows appreciable variability in the size of month to month fluctuations. Further, as already indicated, a trend in price only manifests itself over a period of some months. Accordingly, an "average" over a run of months

preceding the month in question is taken as the measure of the recent adjusted trend. The particular formula used for the average is known as "exponential smoothing" because the weight given to each past month diminishes exponentially; gives about two-thirds weight to the latest three months, about one-quarter to the preceding three months and the small remainder to earlier months.

12. The final step in the calculation of the recent adjusted trend for retail prices as a whole is to combine the rates for the individual components. The weights appropriate for combining these are those of the index basket at the previous January brought up to date to allow for subsequent price movements (other than those on account of changes in expenditure taxes since this category is first deducted and then added back on to the movement in the overall index). The weight for mortgage payments, appears both in the mortgage interest rate component and in the component for "other items" which includes the effects of changing house prices. Thus in May 1982, the make-up of the overall recent trend rate was:-

| | Weight (Out of 1000) | Recent adjusted trend for individual items (annual rate - per cent) | Contribution to overall recent adjusted trend |
|---|---|---|---|
| nationalised industry prices | 94 | 14.4 | 1.4 |
| rents | 38 | 12.3 | 0.5 |
| rates | 44 | 14.9 | 0.7 |
| mortgage interest rate | 37 | 3.8 | 0.1 |
| seasonal food | 36 | 27.8 | 1.0 |
| other items | 788 | 5.4 | 4.2 |
| | | | 7.9 |
| Budget changes in expenditure taxes | | | 0.9 |
| All items | | | 8.8 |
| Quoted as | | | "about 9 per cent" |

Because of the inevitable degree of approximation in the calculation, the overall rate is shown rounded to the nearest half per cent; for example a figure of $8\frac{1}{2}$ per cent would be quoted as "8-9 per cent".

Statistics Division
Department of Employment

July 1982

TABLE : RETAIL PRICES INDEX - "THE RECENT ADJUSTED TREND" AND ITS COMPONENTS

| | ALL ITEMS (1) | "MAINLY PRIVATE SECTOR" | MAINLY ADMINISTERED ITEMS | "MAINLY ADMINISTERED" ITEMS | | | | | SEASONAL FOODS |
|---|---|---|---|---|---|---|---|---|---|
| | | | (EXCLUDING CHANGES IN EXPENDITURE TAXES) | NATIONALISED INDUSTRIES | RENTS | RATES | MORTGAGE INTEREST RATE | CHANGES IN EXPENDITURE TAXES | |
| Weights | 1,000(2) | 803 | 209 | 91 | 36 | 41 | 41 | 140 | 29 |
| | | | | | | | ANNUAL RATES - PERCENTAGES | | |
| 1977 Jan | 19-20 | 17.2 | 13.3 | 15.0 | 15.1 | 8.6 | 11.4 | 8.2 | 36.5 |
| Feb | 18 | 16.1 | 12.9 | 14.7 | 14.9 | 7.4 | 11.4 | 8.2 | 32.0 |
| Mar | 18 | 16.3 | 12.9 | 14.6 | 14.7 | 7.4 | 11.4 | 8.2 | 26.1 |
| Apr | 17 | 14.4 | 13.1 | 13.2 | 15.4 | 12.2 | 11.4 | 14.4 | 20.5 |
| May | 17 | 15.0 | 12.7 | 12.9 | 15.9 | 11.7 | 9.5 | 12.3 | 17.5 |
| June | 17 | 15.1 | 12.6 | 13.2 | 15.6 | 12.1 | 7.1 | 12.3 | 19.7 |
| July | 16 | 14.2 | 11.2 | 11.9 | 15.4 | 12.0 | 1.8 | 12.3 | 23.4 |
| Aug | 16 | 14.8 | 10.5 | 10.8 | 15.3 | 12.4 | 0.0 | 10.1 | 22.5 |
| Sept | 15 | 14.1 | 9.7 | 9.8 | 13.7 | 12.4 | 0.0 | 10.1 | 12.7 |
| Oct | 12-13 | 12.2 | 8.7 | 10.2 | 12.1 | 12.4 | -8.1 | 10.1 | 0.3 |
| Nov | 11 | 10.7 | 8.8 | 10.3 | 13.1 | 12.4 | -9.5 | 10.1 | -7.8 |
| Dec | 10 | 10.0 | 7.2 | 10.5 | 13.1 | 12.4 | -22.4 | 10.1 | -12.6 |
| 1978 Jan | 7-8 | 7.9 | 7.3 | 10.7 | 12.8 | 12.4 | -22.4 | 4.5 | -16.0 |
| Feb | 8 | 8.3 | 7.0 | 11.3 | 13.0 | 12.4 | -29.4 | 4.5 | -18.0 |
| Mar | 8 | 8.5 | 6.9 | 11.3 | 13.2 | 12.4 | -30.6 | 4.5 | -18.5 |
| Apr | 7 | 8.9 | 5.3 | 10.4 | 9.4 | 9.5 | -30.6 | -1.9 | -17.8 |
| May | 7 | 8.7 | 5.0 | 8.7 | 9.3 | 9.8 | -26.1 | -1.9 | -15.4 |
| June | 7 | 8.4 | 4.9 | 7.8 | 10.1 | 9.8 | -24.4 | -1.9 | -12.5 |
| July | 7-8 | 8.4 | 6.1 | 8.7 | 9.9 | 10.0 | -16.9 | -1.9 | -8.5 |
| Aug | 8 | 8.4 | 7.0 | 8.9 | 9.6 | 10.0 | -7.7 | 0.0 | -5.4 |
| Sept | 8 | 8.2 | 7.6 | 9.9 | 10.0 | 10.0 | -7.7 | 0.0 | -3.1 |
| Oct | 8 | 8.0 | 7.7 | 7.9 | 9.6 | 10.0 | 1.0 | 0.0 | -1.6 |
| Nov | 8-9 | 8.5 | 8.0 | 8.0 | 9.9 | 10.0 | 2.6 | 0.0 | 0.2 |
| Dec | 9 | 9.0 | 8.6 | 6.9 | 10.0 | 10.0 | 11.1 | 0.0 | 3.3 |
| 1979 Jan | 9 | 8.6 | 10.2 | 6.5 | 9.4 | 10.0 | 22.6 | 0.0 | 9.8 |
| Feb | 10 | 8.8 | 12.3 | 6.4 | 9.3 | 10.0 | 34.7 | 0.0 | 15.3 |
| Mar | 10-11 | 9.2 | 13.0 | 6.3 | 9.3 | 10.0 | 38.2 | 0.0 | 19.7 |
| Apr | 11-12 | 10.3 | 13.7 | 5.7 | 8.1 | 16.0 | 38.2 | 0.0 | 19.5 |
| May | 12 | 10.6 | 13.8 | 5.2 | 9.8 | 16.2 | 38.2 | 0.0 | 19.2 |
| June | 15-16 | 15.3 | 13.8 | 4.8 | 9.5 | 16.2 | 38.2 | 0.0 | 17.1 |
| July | 21 | 17.8 | 13.6 | 6.7 | 9.6 | 16.2 | 32.3 | 31.9 | 14.9 |
| Aug | 19 | 15.8 | 12.2 | 8.1 | 9.5 | 16.2 | 21.3 | 31.9 | 13.1 |
| Sept | 18-19 | 14.9 | 13.4 | 10.8 | 9.2 | 16.2 | 21.3 | 31.9 | 13.3 |
| Oct | 18 | 14.2 | 14.3 | 12.2 | 11.3 | 16.2 | 20.5 | 31.9 | 15.7 |
| Nov | 17-18 | 13.2 | 15.0 | 13.7 | 11.2 | 16.2 | 20.5 | 31.9 | 18.3 |
| Dec | 17 | 12.9 | 13.7 | 14.7 | 10.7 | 16.2 | 11.4 | 31.9 | 18.7 |
| 1980 Jan | 18-19 | 14.0 | 17.9 | 17.7 | 11.2 | 16.3 | 24.5 | 31.9 | 14.5 |
| Feb | 19 | 14.4 | 19.4 | 19.0 | 10.8 | 16.3 | 28.8 | 31.9 | 10.5 |
| Mar | 20 | 15.4 | 20.1 | 20.9 | 10.9 | 16.3 | 27.7 | 31.9 | 7.4 |
| Apr | 21-22 | 14.4 | 24.5 | 23.1 | 22.1 | 26.7 | 27.7 | 43.0 | 6.6 |
| May | 21 | 13.4 | 25.6 | 25.9 | 20.4 | 26.9 | 27.7 | 43.0 | 4.7 |
| June | 20 | 12.3 | 27.4 | 29.3 | 22.0 | 26.9 | 27.7 | 43.0 | 2.9 |
| July | 16 | 11.5 | 26.7 | 27.8 | 21.7 | 26.9 | 27.7 | 8.4 | 5.2 |
| Aug | 14-15 | 9.5 | 26.2 | 26.6 | 22.3 | 26.9 | 27.7 | 8.4 | 7.3 |
| Sept | 14 | 9.3 | 25.6 | 25.3 | 22.2 | 26.9 | 27.7 | 8.4 | 9.8 |
| Oct | 13-14 | 8.3 | 25.8 | 26.2 | 21.1 | 26.9 | 27.7 | 8.4 | 8.1 |
| Nov | 13-14 | 7.9 | 27.4 | 28.9 | 22.9 | 26.9 | 27.7 | 8.4 | 6.6 |
| Dec | 13-14 | 7.7 | 28.1 | 30.4 | 22.7 | 26.9 | 27.7 | 8.4 | 5.7 |
| 1981 Jan | 12 | 7.7 | 21.1 | 27.2 | 22.7 | 26.8 | -1.0 | 8.4 | 3.5 |
| Feb | 12-13 | 8.9 | 19.0 | 25.9 | 22.9 | 26.8 | -6.3 | 8.4 | 2.3 |
| Mar | 12 | 7.5 | 18.1 | 24.1 | 22.8 | 26.8 | -6.7 | 25.0 | 1.3 |
| Apr | 11-12 | 6.9 | 19.1 | 23.1 | 41.1 | 18.6 | -11.1 | 15.3 | 2.7 |
| May | 11-12 | 6.5 | 19.3 | 22.1 | 42.9 | 21.2 | -13.3 | 15.3 | 5.3 |
| June | 11 | 6.4 | 18.0 | 20.4 | 40.0 | 21.2 | -13.3 | 15.3 | 8.4 |
| July | 11 | 6.3 | 17.5 | 19.5 | 39.6 | 21.2 | -13.3 | 16.5 | 9.0 |
| Aug | 12-13 | 8.1 | 17.5 | 20.0 | 38.9 | 21.2 | -13.3 | 16.5 | 8.1 |
| Sept | 12-13 | 8.0 | 16.6 | 18.1 | 38.8 | 21.2 | -13.3 | 16.5 | 8.5 |
| Oct | 12-13 | 8.3 | 16.7 | 14.7 | 38.6 | 29.1 | -13.3 | 16.5 | 11.7 |
| Nov | 13 | 8.3 | 16.4 | 12.1 | 36.8 | 29.1 | -4.7 | 16.5 | 15.7 |
| Dec | 12-13 | 8.0 | 16.3 | 10.7 | 37.0 | 29.1 | -0.7 | 16.5 | 18.0 |
| 1982 Jan | 11-12 | 6.3 | 16.5 | 10.5 | 36.8 | 26.1 | 3.8 | 16.5 | 21.8 |
| Feb | 10 | 4.7 | 15.7 | 11.1 | 36.6 | 16.6 | 6.8 | 16.5 | 24.1 |
| Mar | 9 | 4.3 | 15.8 | 11.5 | 36.3 | 16.6 | 7.1 | 7.4 | 26.7 |
| Apr | 8-9 | 4.5 | 13.3 | 15.1 | 14.3 | 17.6 | 2.4 | 7.4 | 26.2 |
| May | 9 | 5.5 | 12.3 | 14.4 | 12.3 | 14.9 | 3.8 | 7.4 | 27.8 |
| June | 9 | 5.4 | 12.2 | 14.1 | 12.6 | 14.9 | 8.8 | 7.4 | 25.7 |

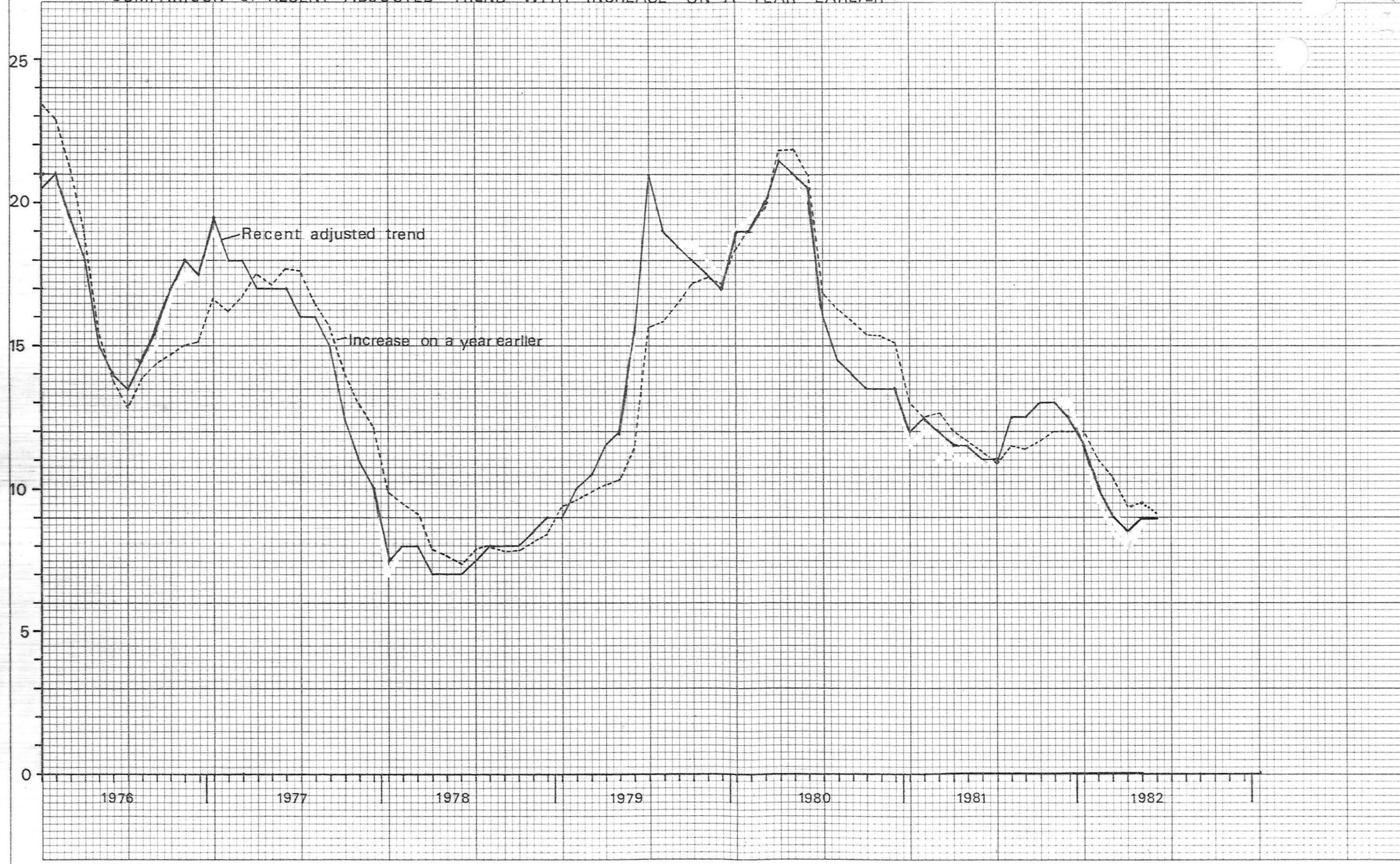
Notes: (1) Figures for the recent adjusted trend will be rounded to the nearest ½ per cent and quoted as approximations eg about 8 per cent or 8-9 per cent.

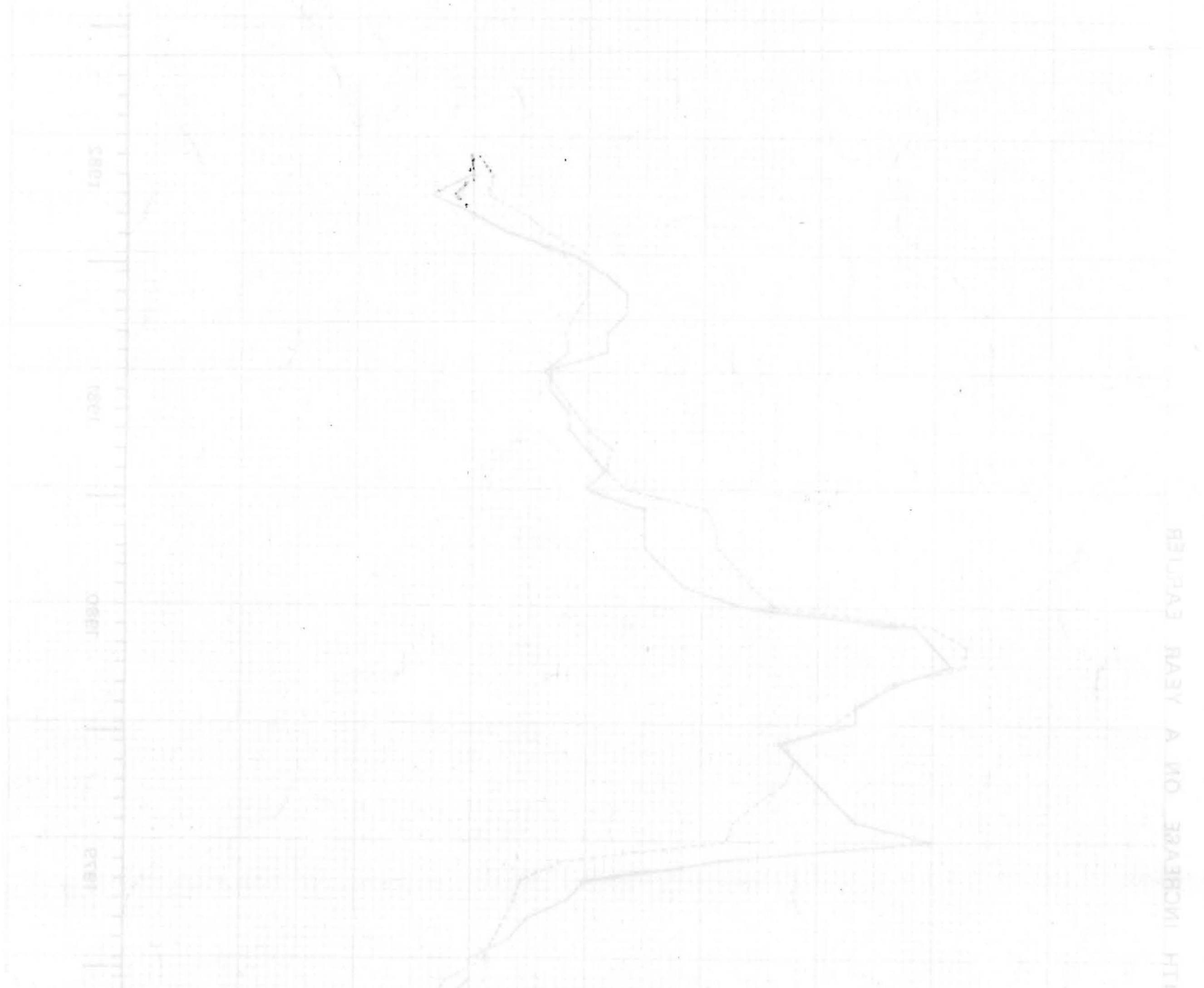
(2) The component weights add to more than 1000 because the prices of some items are affected by more than one factor. Their weight therefore appears under both "administered" and "private" headings. The categories concerned are:

(a) mortgage interest which is affected by changes in the mortgage interest rate (included under "mainly administered" items) and by house prices (included under "mainly private sector")

(b) items carrying advalorem duties, which are affected by changes in expenditure taxes (included under "mainly administered" items) and by changes in the prices of the goods themselves (included under "mainly private sector").

RPI: COMPARISON OF RECENT ADJUSTED TREND WITH INCREASE ON A YEAR EARLIER





CONFIDENTIAL

P, I ~~think~~ one of you still has X bf with Dixon advice.

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

From: A J PHELPS
29 July 1982

CHANCELLOR OF THE EXCHEQUER

cc CST
FST
EST
MST(R)
Mr Burns
Mr Dixon
Mr Moore

X 1. The Secretary of State for Employment wrote to you on 27 July explaining that a new statistical series - the "recent adjusted trend" of changes in the retail prices index - had been prepared and could be circulated to the limited group of ministers and senior officials who receive advance notification of the RPI. I understand that Mr Dixon has been asked to provide a draft reply.

2. The Secretary of State does not propose that the new series should be published and gives his reasons. There is one other point which you may wish to bear in mind should the question of publication be raised at a later date. Because of the way the series has been constructed, publication would be likely to draw attention to the influence on the RPI of changes in expenditure taxes (and other government-influenced prices). In that case there would clearly be a risk of fresh pressure to keep down increases in the specific expenditure taxes or alternatively to change them to an ad valorem basis - and, as you know, frequent study has so far shown the very real difficulties in the way of the latter course.

AJP

A J PHELPS

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Internal distribution: CPS
Mr Middleton

KB



FROM: T J BURR
DATE: 6 August 1982

1. MR DIXON Note at end. PRD 6/8.
2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Burns
Mr le Cheminant
Mr Quinlan
Mr Wilding
Miss M P Brown
Mr H Evans
Mr Kemp
Mr Monger
Mr Mountfield
Mr Pearce
Mr R Allen
Mr Stibbard
Mr Ridley
Mr Phelps - C and E

RETAIL PRICES INDEX: ASSESSMENT OF THE RECENT TREND

In his letter of 27 July, the Secretary of State for Employment seeks your agreement to the production of a new supplementary series to the RPI, for internal use only, to give a better guide to the recent trend. The technical basis of the new measure, and its value as an indicator, have already been agreed with the Department of Employment by Mr Burns and by the Central Statistical Office.

2. We recommend that you endorse the introduction of the new measure. The change in the RPI over the latest 12 months, which is the traditional measure of the rate of inflation, may mask significant changes in trend over a shorter period. Crude measures of the short term trend, such as the annualised change over 6 months, are vulnerable to distortion by major price changes occurring annually and by seasonal factors. The new measure will therefore fill a gap in a key area of policy.

3. But we also recommend you to endorse Mr Tebbit's view that the new series should not be published, for much the reasons given in his letter. A new measure might well tend to confuse and blur public perception of the rate of inflation, and perhaps of the case for reducing it as an object of policy. The new series will also tend to fluctuate around the 12 monthly change, and as Mr Tebbit says pay bargainers might tend to appeal to whichever was the higher of the two.

FROM: [illegible]
DATE: [illegible] August [illegible]

1. MR [illegible]
2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Burns
Mr Le Cheminant
[illegible]
[illegible]
[illegible]
[illegible]
Mr Kemp
Mr Monger
[illegible]
Mr Pearce
Mr R Allen
Mr Gibbons
Mr Ridley
[illegible] - C and E

RETAIL PRICES INDEX: ASSESSMENT OF THE RECENT TREND

In his letter of 17 July, the Secretary of State for Employment seeks your agreement to the production of a new supplementary series in the RPI, for internal use only, to give a better guide to the recent trend. The technical basis of the new measure, and its value as an indicator, have already been agreed with the Department of Employment by Mr Burns and by the Central Statistical Office.

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3. But we also recommend you to endorse Mr Tebbit's view that the new series should not be published, for much the reasons given in his letter. A new measure might well tend to confuse and blur public perception of the rate of inflation, and perhaps of the case for reducing it as an object of policy. The new series will also tend to fluctuate around the 12 monthly change, and as Mr Tebbit says, any bargainers might tend to appeal to whichever was the 'higher' of the two.

Something of the same problem might arise in respect of pressures for larger social security upratings. And Customs and Excise have pointed out (Mr Phelps' minute of 29 July) that publication would be likely to draw attention to the RPI effect of changes in expenditure taxes, thus stimulating pressure to depress them. Finally, there is the elementary point that it would in any case be desirable to gain experience of the new series in internal use before contemplating publication.

4. But none of these considerations is inconsistent with the preparation of the new figures on the restricted basis which Mr Tebbit proposes. I attach a draft reply accordingly.

T J Burr

T J BURR

I warmly welcome the RAT for the RPI — it goes a long way to fill a gap of which we have all long been conscious. I hope it will be published when a little experience has been obtained; but I agree to internal use for that purpose first. Some colleagues are naturally anxious about the possible destabilising effect of the RAT — giving sooner and sharper indications than the annual change in the RPI; for this reason it is unlikely to be suitable for indexing payments/taxes and pressures in that direction would need to be resisted (divergences would cancel out in the long run). But it would be helpful in a pay context when (as now) the trend is down.

PVJ 6/8.

c/8 ~~upt type~~

DRAFT LETTER FROM CHANCELLOR OF THE EXCHEQUER TO SECRETARY OF STATE FOR EMPLOYMENT

RETAIL PRICES INDEX: ASSESSMENT OF THE RECENT TREND

Thank you for your letter of 27 July.

for internal use on a confidential basis.

2. I am content that we should proceed with the production of the new series. But I entirely agree with you that this is not an indicator which we would want to publish.

86 Eaton Square, London SW1

PWP

PERSONAL

6th August, 1982.

Spoke to KEC. A paper for PM (+ Chanc) to be ready on Tuesday

JG.

C.

I've checked with FERB. This is the one in the PM's mind (She – like me! – saw it for the first time today!)

JG.

Dear John Kerr,

I was glad to see that Study Groups were set up after the last Summit but I feel very strongly that the area of their study ought to be urgently enlarged to include the banking problems. I was asked by a friend of George Shultz to prepare a paper on this for transmission to him and I enclose a copy which the Chancellor might care to look at. I have already bombarded No. 10 and the Bank and sent Ken Couzens a copy.

I hope we might meet and talk when I am back at the end of the month.

Yours

Harold Lever

Encl.

So that the passages I've marked were played back to me > or < direct – which explains why FERB hadn't heard it before.

I see some tendency to accept H.L's expressions of concern; but am << sure about his prescriptions (not: I just don't know) The I regard them but :. [illegible] position + perhaps for Weds with No. 10 taking [illegible]

# DEFICIT FINANCE - BANKERS AND GOVERNMENTS

## DIAGNOSIS

This note focuses on the failure of the Western nations to respond adequately to the financial and banking implications of the OPEC cartel.

The artificially high price of oil after 1973 produced enormous current account surpluses for many of the OPEC countries. These surpluses had their mirror image in the deficits of the oil consuming countries, many of the weaker of whom seem likely to remain in chronic or semi-chronic deficit because of their difficulties in raising the relative price or volume of their exports. The governments of the leading countries, motivated by economic, political and moral considerations, recognised that finance would have to be found for these weaker countries for an extended period. But it was not possible, within the existing philosophy and budgetary mechanics, for these governments to provide directly anything like the amount of finance needed. They turned instead to the softer option of encouraging their private bankers to recycle to the weaker countries the vast deposits from the OPEC surplus. The private bankers were not slow to respond.

It would have been virtually impossible for the banks to undertake this novel, enormous and continuing recycling operation within the constraints

come into being mainly to escape tax complications and such regulations on bank lending as existed prior to OPEC. Thus, a vast recycling operation proceeded apace after 1974 and in large part through the Eurodollar market. All the great banks of all the great countries were drawn in. Funds flowed plentifully to virtually all the State borrowers in South America, Africa, Asia and even to the Soviet Bloc. Many of the countries who drank from this pool did so not merely to finance their deficits but also to add to their reserves.

A "solution" having been found to the problem of deficit financing, the leaders of the West appeared to feel that they were largely exempt from the need for any further action; they preferred to ignore the fundamental weaknesses of these arrangements. These may be summarised:-

1. The lending effectively under-wrote OPEC's monopoly price and provided the means whereby many of the poorer customers of OPEC could continue to pay whatever price OPEC felt able to exact.

2. There was no decision by governments or central banks on the volume or direction of the recycling, which were left to the reflexes of the private banking system. As a result, no decision was taken as to the total amount of resources that should be channelled through the Western banking system, nor as to how that vast sum should be apportioned between the borrowing

interests of the governments of the West. The irony is that as borrowers have successively come under pressure to meet their obligations, the West has falsely been charged with neo-imperialism whereas in fact, a vast, unprotected and largely unconditional transfer of resources has taken place.

3. The economies of many of the borrowing countries were such that only by further borrowing for an indefinite period could they meet their interest and repayment obligations. Neither the leading governments nor the private bankers seriously considered whether the borrowing by these largely impoverished nations could be treated as a purely commercial operation. The inevitable ballooning of the debt, from each year's deficits and accrued interest, was, during the early years, somewhat mitigated by the fact that interest rates were low or even negative in real terms. But the problem has more recently been sharply aggravated by the move into very high real interest rates.

These factors produced a dynamic of increasing incredibility built into the system - a built-in self-destruction of vulnerable arrangements which must ultimately threaten the flow of funds, the demand in world trade which they finance, the political and economic stability of the fragile borrowers and the banking system itself.

There are two further points to note. First, this massive use of

Broadly, the multinationals have borrowed on a scale roughly comparable to that of the sovereign borrowers. The over-optimism that infected the market with respect to the latter seems also to have spilled over to the former. The result is that many of the loans to large corporate borrowers are as shaky as those to the sovereign borrowers, and the banks now have two major classes of non-performing assets. Secondly, to make matters worse, the combination of recession, high interest rates and a long period of inflation has driven business and industry within the advanced countries themselves to rely ever more heavily on their domestic banking systems for finance. The banking system as a whole, therefore, is at all points heavily exposed to a unique degree.

We must note, too, that the growth in the Eurodollar market has serious financial implications for the economies of all countries and for their parities. The prudential control and regulation of this enormous market has, by normal banking standards, always been inadequate. The market has been fed by OPEC surpluses but has also attracted surplus cash from the banks in the advanced countries themselves; in addition, the liquidity resources of many multinationals and even of some central banks were added to the total. We have thus allowed to develop a vast and unregulated cash mountain, restlessly moving between currencies to become a major source of parity instability. Moreover, these fund movements jeopardise any attempt

THE PRESENT FRAGILITY

We have in being a system of deficit financing extremely vulnerable to economic and political spasms and dependent on a high level of technical financial expertise in countries where neither that nor political stability is usual. Criticisms of the fundamental long-term incredibility of this system of lending were, for a number of years, brushed aside by the governments and the bankers themselves. But reality is brutally breaking through. The ballooning debt of countries with only a fragile prospect of ever making repayment has now reached hundreds of billions of dollars. Numerous small defaults have been followed by larger ones, and others, even larger, threaten. Nearly all of the great banks in the Western banking system are heavily overexposed. The assets against which they have lent their depositors' money are increasingly called into question. Actual default has so far largely been covered over, and formal default avoided, since the latter would have manifestly devalued the bankers' assets in their balance sheets. "Rescheduling" amounts to little more than exchanging a basically incredible promise to pay which has in fact been defaulted for another basically incredible promise to pay at a later date. This process is breaking down. The sheer mechanical problems, complex in the extreme, of hundreds of banks agreeing to roll over past obligations are becoming overwhelming. More important, the larger the scale of these operations the less their effec-

depositors. Moreover, the inducement to the bankrupt borrowers to co-operate is the prospect of new money - this is increasingly difficult to achieve, even under government pressure. The banking system has become hostage to its impoverished debtors.

We now seem to be at the beginning of a period of maximum anxiety for the banks, and individual banks are already experiencing considerable pressure. First, interest payments and repayments of principal have been missed on a substantial scale, leading to a growing cash flow problem for the banks. Secondly, the nervousness of certain depositors is already in evidence. Central banks, who should never have been depositors in the first place, and some multinationals and other investors are withdrawing their deposits on a big scale. Thirdly, the pattern of balance of payments surpluses and deficits is beginning to shift. OPEC surpluses have recently been eroded and some OPEC countries are drawing down deposits to finance their deficits. Unhappily, there is no assurance that the recipients of these funds are depositing them in the same way as these OPEC countries did. Of course, the funds remain somewhere in the banking or central banking system; but a serious problem of mismatch is sure to develop. The banks are thus imminently facing a highly dangerous combination of deposit withdrawals and non-performing assets. The credit markets' reaction is clearly illustrated in the loss by all the major US banks (save Morgan Guaranty) of

AN OUTLINE OF THE REMEDIES

The twin central problems which now face us are

(1) How to cope with the threat that the past lending represents to the financial stability of our banks and of the borrowers?

(2) How to ensure a sustained flow of lending in the future? If this is not achieved, a considerable percentage of the advanced countries' exports would vanish as the finance for them is reduced. This is to say nothing of the damage caused to the politics and economics of the borrowers and ultimately the danger to the banking system itself with multiplier effects throughout the world's economy. The political consequences for the advanced countries need no emphasis.

???

The governments of the world must now accept some responsibility for past lending and must undertake the necessary supportive action to ensure an adequate future flow. They encouraged the banking system to undertake this lending while guaranteeing only a small proportion of it. Indeed, they often brought pressure on the banks in pursuit of what were basically the political and economic purposes of governments. They must now accept some responsibility in order to protect both these purposes and the banking system.

Bank both to regulate international finance and to act as lender of last resort. However, we cannot wait for this highly desirable development in order to handle the present dangers. We must at once move to ensure that each central bank acts to support its own private banks by protecting their liquidity situation in the event of defaults or postponements in payment by sovereign borrowers on existing debts. This can be done in a variety of ways. Where such lending has been normal and broadly prudent (so far as that term can be justly used in relation to a wildly imprudent system) each central bank could, for example, offer to discount where necessary the paper of the lending banks and to roll-over interest and repayment to match any defaults or delays by the borrowers. Alternatively, the central bank could buy assets guaranteed by the private banks. The central bank in question would accept delays of interest and repayments subject to a commitment whereby the banks wrote down, as required out of their profits and over a long period, the loans on which there had been default or where payment had been delayed. The banks would be making continuous repayment to the central banks out of their profits as well as out of any funds accruing from their defaulting debtors. Some such arrangement would protect the banking system while exculpating governments from the charge that they were themselves meeting the costs of the banks' misjudgements. It would, in effect, sustain our banks by enabling them to extend

abrupt write down would have calamitous consequences. It is in our interests as well as those of the banks to make arrangements which give them time to pay for their own errors and avoid the backlash on us all.

It would be quite inadequate for some arrangement like the above to be carried out by individual central banks acting in isolation from one another. When the difficulties materialise, the central banks must be acting in harmony and be clearly seen to be so acting. There are two reasons for this. First, if the private banks of one or two countries are called into question there are very likely to be massive movements across the foreign exchanges as depositors seek areas of greater safety. This process has already started and parities have already been distorted. Collective arrangements for avoiding further gyrations and distortions in parities must be achieved before the process gets out of hand. This work should be co-ordinated with the Study Groups set up at the last Summit. Secondly, and even more importantly, we must at all costs head off any further widespread withdrawal of funds from the banking system in favour of government obligations, which will certainly take place if bank defaults start and if joint action by governments is not visible. Though individual central banks are to retain responsibility for the banks in their own countries, that responsibility should be in relation to a wider collective

must bring into being a systematic and sustainable system. A bare outline of how this might be done is as follows. A committee of central banks, in collaboration with their governments could prepare a periodic outline of the total volume of liquidity recycling or bank lending which is likely to be needed. This overall sum would then have to be apportioned between the prospective borrowing countries. Lending banks would be required to register their proposed loans with the committee, and if there is delay or default by the borrower, the central banks would stand ready to cover the liquidity and solvency problems of the banks broadly on the lines I have outlined in respect of past lending. The lending banks would, as part of their relationship with the central banks committee, be required to submit consolidated balance sheets so as to bring the overall Eurodollar lending under central bank supervision. These arrangements would, of course, have to be operated flexibly. But if international lending is to continue on an appropriate scale, other action will be required by governments. For example, it will be necessary for the IMF and other international institutions to develop a more prominent, coherent and predictable supportive role.

This is a bare outline of my proposals and I will be happy to discuss them more fully if required. In the past, the world's leaders, their finance ministers and the central banks have reacted only to crisis, without even an outline strategy to guide them. To do the same on this occasion

imperative that we now organise this outline strategy and find effective agencies for implementing it. In my view the alternative will be a series of crises of the gravest kind.

<u>SUMMARY</u>

The banking system of the western world is now heavily and dangerously overextended. If its lending abruptly contracts there will be an avalanche of large-scale defaults world-wide which will inflict extreme damage on world trade and on the political and economic stability of the borrowing and lending countries. It was broadly right and necessary for the Western countries to mobilise their private banks in support of global political and economic interests. It was in the highest degree dangerous that governments failed collectively to accept the commitments and responsibilities which would have both supported and disciplined the activities of the banks.

The problems I have discussed are an important part of our central problem, namely, that in a world which has become increasingly interdependent we lack agencies capable of thinking about the system as a whole and of organising collective action to defend our global interests.

Harold Lever

3rd August, 1982

KB

Let's use the USA, robustly, - + 1 or 2 [illegible] UK (the [illegible])

CONFIDENTIAL

original copy to Mr [illegible] M. (copy for me)

FROM: D RAYNER 389/8

DATE: 23 August 1982

1. MR ~~BURR~~ Note below TJ Burr 24/8

2. MR HARRIS

cc Mr Traynor o/r

PAY

[ For Party Conference Speech: I suggest, if anything, using the buses - below)

I understand that you discussed with Mr Burr early last week what evidence there was of 'nil' pay settlements in the 1981-82 pay round.

2. We prepared an extensive note on this subject earlier in the year (minute of 6 April attached) in response to a similar request from the Chancellor. This concluded that although there had been a good deal of publicity in the media over the past few months about wage cuts, freezes, and deferred settlements, this had to a large extent related to proposals for such action, rather than to agreements reached. However, we were able to identify some examples of zero or deferred pay settlements in the current round, details of which were set out in the annex to the 6 April submission.

3. Since April, a couple of further reports of nil pay settlements have come to light, and these are discussed in the attached annex. This also includes, where appropriate, updated information on the examples covered in the 6 April submission.

4. As regards the examples of such agreements in the US described in the 6 April submission (covering Pan Am and Ford Motors), EF2 confirm that these are still in operation. Indeed it is their understanding that similar agreements have since been reached between the United Autoworkers Union (UAW) and both the American Motor Corporation and General Motors. EF2 add that their contacts in the embassy in Washington will be forwarding later this week details of further recent instances of zero or deferred pay settlements in the US (reported to be in the steel, trucking and airline industries). We shall of course pass this information on to you as soon as it arrives. X

D Rayner.

D RAYNER

I fear that there are few telling examples here. You could use ICL, but preferably not Hoover; we do not want to imply approval of 7% for the coming pay round. X You may also wish to use Hants & Dorset without naming names, as suggested by the Chancellor. If so, I think we ought to clear the proposed words with the Dept. of Transport.

As regards the US, you could mention the motor industry: the willingness to trade pay for job security is a useful feature. Pan Am looks OK. And there may be more to come (X).

TJ Burr 24/8.

CONFIDENTIAL

CONFIDENTIAL

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CONFIDENTIAL

ANNEX

ZERO OR DEFERRED PAY SETTLEMENTS IN 1981-82

Hoover Limited

Following lengthy negotiations with their workforce, Hoover wrote to the Chancellor on 24 May to confirm that they had reached agreement on a zero pay settlement for 1982. However, as a condition of the pay standstill in 1982, it was also agreed that there would be a guaranteed 7 per cent increase in 1983 - well above the level of pay settlements the Government is looking for in the coming year.

British Airways

In the case of BA, where the pay of all employees was frozen from their 1 January 1982 settlement date, it has recently been announced that there will be pay increases of around 11 per cent with effect from 17 October 1982 as part of an agreement lasting until the end of 1983. As the Chancellor commented in his note to the PM on the latest public trading sector pay monitoring report, this is a disappointing outcome given BA's success earlier in the year in avoiding any pay increase at all.

National Bus Company

Employees of the NBC's Hants and Dorset subsidiary recently agreed to accept a £14 per week cut in overtime pay in order to maintain employment. Hants and Dorset had a problem of excess capacity which they intended to resolve through a stronger seasonal pattern of services to reflect the importance of holiday demand on the south coast. This would have meant a marked reduction in staff requirements over the year as a whole. But because staff agreed in local negotiations that they should be rostered for less hours (with a consequent loss of earnings), job losses were avoided.

However, the Department of Transport are anxious that this agreement should not be publicly quoted. A similar local agreement was reached a couple of years ago in Northamptonshire, which was publicly quoted by the Prime Minister. As a result the matter came to the attention of the national leadership of the TGWU, who insisted that the agreement should be reversed as contrary to union policy. In consequence jobs were lost. Although Hants and Dorset busmen are represented by the NUR rather than the TGWU, publicity could still be prejudicial to the existing agreement, and to the prospects for the further similar agreements which are likely to be reached in the industry.

ANNEX

## ZERO OR DEFERRED PAY SETTLEMENTS IN 1984-85

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## ICL

It has been reported that staff and manual workers employed by ICL did not receive any pay increase during 1981. The company's London Weighting allowances were also not increased last year. Increments (worth around 3 per cent to all staff) were also delayed for 3 months.

All ICL employees have now received pay increases of 5 per cent in 1982, the manuals with effect from 1 January, and the main staff group with effect from 3 June.

## British Caledonian

It has been reported that the salaries of most British Caledonian employees, which were due to be raised in January 1982 following the expiry of a two-year index-linked agreement in December 1981, are to be frozen for most of 1982. Negotiations are however expected to begin shortly with a view to part of an earlier guaranteed 10 per cent minimum increase in 1982 being paid before the end of December.

## Burman Brothers

Earlier reports of a possible pay cut at Burman Brothers have now been supplanted by the introduction of a new bonus scheme. Ironically, average earnings during the first week of the scheme (designed to improve productivity and cut costs) increased from £142 to £153.

FROM: D RAYNER

DATE: 6 April 1982

1. MR BURR TJBurr 7/4
2. MR BUCKLEY MWA
3. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Ryrie
Mr Le Cheminant
Mr Quinlan
Mr Dixon
Mr Pearce
Mr Kemp
Miss Kelly
Mr Buckley
Mr Morgan
Mr Ridley

PAY

Following Mr Willetts' minute of 22 March, you asked at your meeting of 25 March for sample figures of earnings for selected groups in cash terms (rather than in terms of annual percentage increases in earnings).

2. The attached table gives details of the average gross weekly earnings of a wide range of public sector groups over the period April 1979 - April 1981, based on the New Earnings Survey for each year. Although the figures are "averages" covering groups of employees, the groups concerned are sufficiently well defined to give a useful idea of typical earnings in the services or industries concerned. The table does not include figures for specific private sector employees, since these are not categorised into industry-wide groups for pay purposes in the same way as in the public sector.

3. At the same meeting, you also asked for recent examples of <u>nil</u> pay increases (Mr Jenkins' minute of 25 March raises the same question).

S 7/4

4. We have drawn on four main potential sources: the Department

of Employment pay monitoring information; data published by the Engineering Employers' Federation; the regular Reports by Incomes Data Services, which provide a survey of a wide range of individual pay settlements; and the CBI's Pay Databank Reports. A note setting out the information which we have been able to put together is attached at annex B. The available sources do not always distinguish between genuine "nil" pay increases and increases which are deferred (though some deferrals are merely deferrals of implementation, with a back-dated settlement to follow). For example, the EEF report that 8.2% of employees in October and November 1981, and 9% of employees in December 1981 and January 1982, had "nil" or deferred pay settlements. These figures are not broken down further, but would appear to relate mainly to deferred settlements. Annex B therefore includes some cases of deferral as well as nil settlements.

5. This information yields few useful examples of zero settlements. But this is consistent with our impression that some of the publicity given in recent months to an apparent willingness to accept wage cuts or a wage freeze has related to proposals for such action, rather than to agreements reached. Hoover, for example, originally announced a 10% pay cut from January 1982 and a pay standstill until profitability was restored; but this was later withdrawn in return for Union agreement to discussions (still continuing) on productivity changes to achieve the same reduction in costs. In the last few days a front page report in the Financial Times referred to the possibility of a pay cut at Burman Brothers, an engineering firm in the West Midlands. But again the position so far is that the employers are asking the work force to accept a pay cut, not that a nil settlement has been agreed or is likely to be reached.

6. In other cases the willingness of some staff to forego an increase may attract attention, without being sufficient to secure agreement to a zero settlement. The case of lecturers at Aberdeen University, mentioned in Mr Jenkins' minute of 25 March, appears to be in this category. A proposal to accept nil pay settlement in order to avoid staff cuts was put forward on a very tentative basis at a local branch meeting of the AUT; but it should not be regarded at this stage as being representative of the views of Aberdeen University lecturers. Although it is theoretically possible that the pay freeze proposal could be adopted, DES consider

that the necessary unanimity amongst the lecturers is extremely unlikely to be achieved.

7. Even a national or company agreement to a freeze may not mean that pay actually stands still. The <u>British Steel Corporation</u> reached agreement with the ISTC some months ago to forego a national pay award in 1982; but room was left for increases geared to local productivity deals. There are indications that some substantial increases are taking place at local level .

8. Finally, we have informally contacted the CBI staff to ascertain whether they were aware of any significant instances of zero pay settlements which we had failed to identify. Their "databank" survey of manufacturing includes 10 settlements (covering 1211 employees) of 3% or less in the current pay round, of which 7 (covering 924 employees) are for zero settlements. These figures compare with the total of 532 settlements monitored, covering 180,423 employees. The CBI confirmed that, although they were refining their inquiries of firms to pick up deferred increases better, they had no other significant information on zero settlements in this pay round.

D Rayner

D RAYNER

Annex A

AVERAGE GROSS WEEKLY EARNINGS*

| | | April 1979 | April 1980 | April 1981 | Cumulative Increase April 1979-April 1981 |
|---|---|---|---|---|---|
| **Central Government** | | £ | £ | £ | % |
| - Civil Service : | Middle and higher grades | 123.9 | 169.1 | 182.0 | 46.9 |
| : | Clerical grades | 71.7 | 92.4 | 94.1 | 31.2 |
| - NHS : | Nurses (Women aged 18 and over) | 66.1 | 87.4 | 99.7 | 50.8 |
| : | Admin. and clerical grades | 109.3 | 135.6 | 155.3 | 42.1 |
| : | Ancillaries | 72.2 | 97.9 | 99.3 | 37.5 |
| - Armed Forces+ : | Major | 177.9 | 211.6 | 238.4 | 34.0 |
| : | Private 1 | 78.0 | 96.4 | 105.4 | 35.1 |
| **Local Government** | | | | | |
| - Teachers (Primary & Secondary E & W) | | 106.3 | 125.0 | 170.9 | 60.8 |
| - Police (Ranks below superintendant) | | 118.9 | 154.7 | 172.0 | 44.7 |
| - Firemen (Operational ranks below station officer) | | 94.7 | 117.4 | 137.8 | 45.5 |
| - LA Manuals | | 75.3 | 96.5 | 103.7 | 37.7 |
| - LA APT&C | | 101.6 | 130.0 | 154.5 | 52.1 |
| - NCB : | Management and Clerical | 115.3 | 155.8 | 196.6 ≠ | 70.5 ≠ |
| : | Underground Mineworkers | 125.8 | 151.3 | 162.5 | 29.2 |
| - British Rail : | Salaried Staff | 104.9 | 129.4 | 145.5 | 38.7 |
| : | Conciliation Staff | 89.9 | 104.1 | 120.9 | 34.5 |
| - Gas : | Gas Staffs and Senior Officers | 112.0 | 134.4 | 159.3 | 42.2 |
| : | Gasworkers | 95.3 | 129.8 | 143.9 | 51.0 |
| - Electricity : | Admin and Clerical grades | 103.5 | 118.5 | 142.5 | 37.7 |
| : | Technical Engineering Staff | 148.1 | 214.8 | 233.7 | 51.1 |
| : | Manuals | 94.9 | 131.3 | 143.8 | 51.5 |
| - Water : | Water service Staff | 114.9 | 137.0 | 167.6 | 45.9 |
| : | Water service manuals | 88.7 | 111.6 | 123.0 | 38.7 |

Source: New Earnings Survey each year 1979-81.

* Full time men aged 21 and over (unless otherwise stated), whose pay during the survey period was not affected by absence.

\+ Includes appropriate length of service increments but no allowances. For the ranks shown, much the greater proportion would get no additional allowances.

≠ Figures for this year include all periodical bonuses and are not wholly comparable with those for previous years.

DEFERRED SETTLEMENTS IN THE CURRENT PAY ROUND

1. British Airways

BA have secured the acceptance of virtually all employees that any pay increase in the current round should be deferred from the normal operative date of 1 January 1982 until at least September of this year.

2. British Caledonian

British Caledonian employees were eventually given the opportunity of individually agreeing to forego two agreed cost of living increases of 4 per cent each, on the understanding that these would be restored when the airline returned to profitability.

3. Dan Air

Dan Air have put off any increase in the current round for a minimum of 3 months, until April at the earliest.

4. Bronx Engineering - Stourbridge

As with the hourly paid employees, there was reported to be no pay increase for salaried staff from their normal anniversary date of 1 August 1981. This followed short time working on the shop floor since December 1980, and for staff since April 1981. There is, however, provision in the agreement for re-opening, and formal negotiations for the 145 staff will begin when the company's position improves.

ZERO SETTLEMENTS

5. Short Brothers - Belfast

About 6,000 workers employed by the aircraft and missiles plant of Short Brothers in Belfast were reported in December to have accepted a wage freeze in the current round. Short Brothers have not been profitable for something like 10 years, and have received Government subsidies for much of that period.

6. Crane Fruehauf

Around 780 manual workers at Crane Fruehauf's two remaining plants at Dereham and North Walsham in Norfolk accepted a 12-month pay freeze from their November settlement date (while reserving the right to re-open negotiations during 1982). About 600 staff have also been asked to forego their February 1982 increase. Both staff and manuals have, however, had pay increases within the last 12 months because of a deferred pay increase in autumn 1980. In July 1980 the three manual unions (TGWU, AUEW and GMWU) agreed two-stage increases over 16 months. An increase of 10 per cent was paid in July 1980, with a further 10 per cent in November 1980. The second stage was, however, delayed till March 1981. Staff had a 10 per cent increase in July 1981.

7. Christie-Tyler

Some 2,300 workers were reported in February to have accepted pay cuts of up to 10 per cent to save 1,000 jobs in South Wales. But the firm have for some years run a bonus scheme which has enabled some of their manual workers to earn up to £400 a week with bonuses (among the highest paid in the country). The cuts can therefore be regarded as no more than an adjustment towards levels of pay more normal for the industry.

DEFERRED/ZERO SETTLEMENTS IN THE USA

There have also been a couple of widely reported examples of similar settlements in the US:

8. PanAm

Staff at PanAm agreed in October to a 10 per cent reduction in the company's payroll costs, and accepted that any increase this March would be frozen until January 1983.

9. Ford-UAW Agreement

Ford Motors of the US agreed terms in February with leaders of the United Autoworkers Union for a contract which will freeze pay for the rest of 1982 and cut workers' fringe benefits. The main

feature of the deal is that Ford workers will give up their next 3 quarterly cost-of-living indexed payments under the existing pay contract to expire in September. For the remainder of the new contract, which runs to September 1984, there will be no lump sum annual increases, as there have been in previous contracts at the rate of 3 per cent a year. In return, Ford's American workers will share directly in the company's profits and enjoy a series of job protection measures comparable to those of some Japanese companies.

**ANNEX A**

MEETING WITH SECRETARY OF STATE FOR INDUSTRY

Brief by EA

5/9/82.

(a) Prospects for the economy as a whole

Inflation

As measured by the RPI, inflation has come down from 12 per cent at end 1981 to 8 per cent by August 1982. Further falls are in prospect [to 6½ per cent by end 1982] - details in EA minutes of 1, 14, 17 September (attached, top copy only). Main features: falling commodity prices, firm exchange rate, continuing productivity gains, single figure wage settlements.

Fiscal and monetary policy

2. So far as can be seen at this stage, the PSBR in 1982-83 is keeping within the budget figure of £9½ billion, despite the extra cost of the Falklands operation. Reductions in interest rates, broadly in line with falling inflation, have been possible within the monetary targets set at budget time [see brief (e)].

Output

3. At budget time, the FSBR projected an increase of ½ per cent in the total output of the economy between the second half of 1981 and the first half of 1982. This is broadly consistent with the emerging data (even though the output measure of GDP suggests little change). But though the total level of output may not be much different, the output of the manufacturing sector in the first half of this year has been about 2 per cent below the budget forecast.

4. Prospects for the world economy over the next year or so now point to a lower level of demand and output than seemed likely in the budget - both for industrialised and primary producing countries. While this is a factor behind the moderation in inflation, it is also depressing the prospects for any growth in UK exports.

5. Continued difficulties in export markets and little evidence of any rise in demand for home produced goods must have been major factors behind the increase in business pessimism since the spring. Growth in output is likely to be lower than foreseen in the budget, at least for a time [probably extending into 1983], and at least for manufacturing.

6. The prospect is inevitably pretty uncertain; recovery in the UK is indeed proving patchy and slow. But the reasons for believing that a sustainable recovery will take place - the expectation of an upturn in the world economy, the benefits from a sharply lower inflation rate working partly through lower interest rates - remain valid, even though nobody can predict the timing with any accuracy. The CSO index of longer leading indicators is now showing signs of rising again.

Unemployment

7. The past few months have seen a faster rise in the underlying trend of unemployment, compared with earlier this year (see brief (d)). Further rises, probably well into 1983, are likely. With unemployment rising in most other countries, the UK is bound to be affected.

Balance of payments

8. The current account has, as expected, been running a surplus this year, though smaller than in 1981. Exports have been lower than expected (as have imports) in part because of the lack of recovery in other countries. [August trade figures to be published on September 24].

5. Continued difficulties in export markets and little evidence of any rise in demand for home produced goods must have been major factors behind the increase in business pessimism since the spring. Growth in output is likely to be lower than foreseen in the Budget, at least for a time (probably extending into 1982), and at least for [illegible].

6. The increase in [illegible] in the UK is indeed proving patchy and slow. But the reasons for believing that a sustainable recovery will take place - the expectation of an upturn in the world economy, the benefits from a general lower inflation rate working partly through lower interest rates - remain valid, even though nobody can predict the timing with any accuracy. The CSO index of longer leading indicators is now showing signs of rising again.

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(b) Prospects for the company sector

1. A detailed paper, circulated by Mr Quinlan on 29 July, pointed to the problems caused by low demand abroad and at home, and to the poor prospective level of profits despite some recent recovery. Since that work was completed, UK interest rates have fallen quite sharply, and commodity prices have weakened. These developments are helpful to the company sector, but arose in part because of continued weakness in the world economy. This, in turn, limits both the likely rise in UK export markets and the prospects of a rise in activity in the UK in the short-term.

2. The continuing fall in inflation should help to reduce the uncertainties felt by many companies. At the same time it emphasizes the need to secure significant falls in the rate of wage settlements if profitability is to improve.

3. The July paper drew attention to the risks that continuing pressure on profits and the financial position of companies could lead to the laying off of more employees and to the postponement of investment projects. Developments since then suggest that these risks have increased somewhat, particularly in the manufacturing sector. While many companies in that sector are still operating on small and precarious margins, the pressure is being reflected in higher productivity and thus in competitiveness.

4. Recent data revisions, published in the 1982 Blue Book, suggest that the fall in the profit share in 1980 and 1981 was not quite as large as had first been thought: latest estimates put the share of (non-oil) company profits in total domestic incomes at over 5½ per cent in 1981, compared to the earlier estimate of under 5 per cent. In 1979 it was 9½ per cent.

(i) Prospects for the company sector

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UNCLASSIFIED

FINANCIAL SECRETARY TO THE TREASURY

FROM: A P HUDSON

DATE: 5 September

PS/CHANCELLOR

cc PS Chancellor
Mr Bailey
Mr Lovell
Mr Faulkner
Mr Gordon
Mr R I G Allen
Mrs Thoms
Mr Lord
PS IR
Mr Lusk OR

**SIR KEITH JOSEPH'S LETTER OF 15 AUGUST**

The Financial Secretary has seen Mr Lusk's 29 August minute.

2. He strongly agrees with the line recommended by Mr Lusk. Paragraph 4(iii) indicates the wide opportunities for business to make payments which attract tax relief already, and these are not yet very widely taken up.

3. From his detailed knowledge as a member of the Court of Governors of the LSE, the Financial Secretary has doubts about the second paragraph of Sir Keith Joseph's letter. After some pressure, the LSE has sought to follow the American example over the past five years, with considerable success.

APH

**A P HUDSON**

CH OR

EXCHEQUER
14 SEP 1982
ACTION Mr Wicks M14/9.
COPIES TO CST
SGD Wass
Mr Quinlan
M Burgner
M Traynor

10 DOWNING STREET

*From the Private Secretary*

10 September 1982

2

COAL INDUSTRY

The Prime Minister held a discussion about the coal industry this evening. Apart from your Secretary of State, the Chancellor, the Secretary of State for Employment, Mr. Jerry Wiggin (Parliamentary Under-Secretary of State for the Armed Forces), Sir Robert Armstrong, Mr. Sparrow and Mr. Gregson were present.

On the tactics to be adopted by the National Coal Board in their pay negotiations with the National Union of Mineworkers, your Secretary of State said that it was hard to predict the course of events. It might be that Mr. Scargill would not wish there to be any negotiation, but would stand on the 23-31 per cent claim, and put the Board's opening offer to a special delegate conference and a ballot. If this were to happen it would be best to proceed immediately to the Board's final offer. But it would be dangerous to assume that there would be no subsequent negotiation. Indeed, the men themselves would almost certainly expect some negotiation to take place. The Board's present thinking was that there would be a negotiation, and so they would not make their final offer at the meeting on 15 September. In Mr. Lawson's view, we could accept the Board's judgement that a final offer of between 7 and 8 per cent on basic rates might well be enough to win through a pithead ballot. The RPI figure which would be published on 15 October would be of crucial importance, since it was likely to be the last such figure published before the ballot.

Your Secretary of State said he was concerned, however, about the Board's intention of offering around 5 per cent on basic rates at the first negotiating meeting on 15 September. There must be a risk that the NUM would describe this as a derisory offer, less even than that available to the National Health Service workers, and would go straight to a ballot on this figure.

/After discussion,

After discussion the Prime Minister said she shared Mr. Lawson's doubts about commencing negotiation at 5 per cent. This was primarily a matter for the Board. But they might be asked whether they had considered their tactics if this approach were unsuccessful. It might be better to start at 6 or 6½ per cent. She shared, too, Mr. Lawson's view of what might be a reasonable final offer. It had been helpful in recent pay negotiations that the Chancellor of the Exchequer had felt able, at the end of July, to predict a fall in the inflation rate to 7½ per cent. He should consider, with the Secretary of State for Employment, whether in advance of 15 October it would be prudent publicly to predict a lower figure by the end of the year.

The Prime Minister said that it was unfortunate that although coal stocks would now be sufficient to permit power station endurance of around 24 weeks, the stocks of ancillary materials could not be increased beyond 9 weeks' duration, the maximum permitted by available storage capacity. After discussion it was agreed that the Electricity Boards should be allowed to begin taking steps now so that storage capacity would be available to permit stocks of ancillaries to be increased to 20 weeks by November 1983, or sooner if possible. The cost, which the CEGB were prepared to absorb within their present EFL was about £30 million for the capital works and about a further £40 million for the increase in stocks of materials. It was recognised that the works would have a certain visibility. But the CEGB would carry them out in as low-key manner as possible, and no obstacle should be placed in the way of their commencing as soon as the CEGB desired.

There followed discussion about when consultations about the use of Servicemen to replenish stocks of ancillaries in power stations should begin. Such consultations, and preparation of a comprehensive plan to re-supply ancillaries to power stations might take up to three weeks. There must be some risk that if the consultations were postponed until very late in the day it might be discovered that there were practical difficulties about the Services carrying out this task. Summing up the discussion, the Prime Minister said that the consultations should not begin until after the pithead ballot. She would not, however, rule out informal and confidential discussion of the task between the Services and the CEGB if the Secretary of State for Energy thought it would be worthwhile himself to arrange the necessary meeting.

I am copying this letter to John Kerr (H.M. Treasury), Barnaby Shaw (Department of Employment), David Arnold-Forster (Ministry of Defence), Richard Hatfield (Cabinet Office) and Gerry Spence (CPRS). I should be grateful if you and they would give this letter the usual limited circulation.

Yours sincerely,

Michael Scholar

J. D. West, Esq.,
Department of Energy.

CONFIDENTIAL

Mr Moore

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
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JF1521

Secretary of State for Industry

13 September 1982

The Rt Hon Leon Brittan QC MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

| CHIEF SECRETARY | |
|---|---|
| REC | 14 SEP 1982 |
| ACTION | MR Chivers |
| COPIES TO | PPS FST EST |
| | MST(R) |
| | SIR D Wass |
| | SIR A Rawlinson |

MR Quinlan
MR Lovell
MR Mountfield
MR Hart
MR Harris

Dear Chief Secretary,

In your letter of 9 August you asked for my latest assessment of the level of bids and offsetting savings well before our bilateral which has since been arranged for 21 September.

2 Before turning to the details of my programme, there are two or three general points which I would like to make. In successive Budgets, the Treasury has been very ready to recognize the crucial importance of industry's contribution to our overall economic policy. Indeed, the Chancellor's paper for last Thursday's Cabinet stressed that the route to the higher growth scenario lay through better growth in output and productivity based on an expansion of the private sector. In all Geoffrey Howe's Budgets, there have been significant benefits for industry both in the form of help to reduce costs (e.g tax cuts, help with energy costs etc) and in support for innovation. Examples of the latter were the "seed-corn" facilities in Autumn 1980 and the "Innovation Package" in this year's Budget. You will know too that I have repeatedly emphasized my desire to switch the balance of my programmes away from the casualties of the past to support for the industries of the future. Although there are serious current anxieties surrounding BSC and BS, there is no question but that the provision needed over the next year or two for these industries will be considerably below what has had to be found in the recent past. You will know too that we have secured a very clear commitment from BL not to seek further money beyond that spelt out in the Concordat approved by the Prime Minister and the Chancellor.

3 What I find very difficult, against this background, is that in the PES context there seems to be so little recognition by the Treasury of our strategy. Accordingly, we have found ourselves, as it were, in a "stop-go" sequence. Each Autumn, I am pressed

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to find difficult and sometimes damaging offsetting savings to cover my new bids; the new bids themselves are sharply trimmed back and some valuable bids simply have to be abandoned. Come the Spring, the atmosphere is quite different, and I am invited to put forward proposals, sometimes at short notice, particularly in the field of small businesses and innovation.

4 This makes consistency of policy and the planning of expenditure very difficult and militates against getting the best value for money. I appreciate all the difficulties of forecasting what freedom of manoeuvre the Chancellor will have for the Budget as far ahead as the Autumn of the preceding year. Nevertheless, I cannot help feeling that there must be a better way of ensuring that the undoubted Treasury belief in the value of our support measures is reflected more consistently both in the PES negotiations and in the Budget.

5 Second, I must reiterate my dismay at the line you took over the bid for launch aid for the W30 helicopter. I still find it impossible to accept that your officials could have been under any illusion that, when I withdrew the bid for launch aid last year as part of my "wedge" and agreed a lower figure which quite expressly excluded launch aid, this was not done on a clear understanding that launch aid for any project found to measure up to the necessary criteria would be met from the contingency reserve. Indeed, the reason which I then gave for preferring this method of handling the matter was that at the time we could not identify which projects would in the end qualify, how much money would be required, and what the phasing of expenditure should be. Thus, at that stage these were precisely the kind of "bids" for which the contingency reserve is intended. That was the clear understanding on our side and it is, to say the least, unfortunate that the minutes prepared by the Treasury did not reflect it. While, as indicated below, we have managed to identify savings to offset the 1983/84 spend on the Westland 30 launch aid, I must make it clear that this is entirely without prejudice to how we should handle any further launch aid bids which I may put forward. Even more important, we must do our very best to avoid any similar misunderstanding in the future. It would be well nigh impossible for us to do business if we found we could not rely on either side sticking to agreements reached in the PES negotiations.

6 Turning to my programme I should like to deal first with what may be described as "involuntary" bids. These include such "imposed" bids as the £50m cut in RDGs introduced but ultimately not agreed last year, the bids arising from shipbuilding loans being repaid earlier (with immediate benefit to the Exchequer), and the bids arising from higher Treasury assumptions on shipbuilding interest support costs. There is little to be done about such bids.

7 Similarly we are reliant on forecasts for "demand-determined" bids on such items as RDGs and the cost of ISERBS

support for redundant steelworkers. I can, however, report that following an examination of the latest BSO investment figures the bids for RDGs can be reduced substantially. Previously we had assumed that the up-turn in RDG spend in 1981/82 reflected a higher than expected proportion of investment (particularly for large projects) going to the Assisted Areas. The latest BSO figures do not bear that out and the 1981/82 position now appears to have resulted from the effects on the transitional arrangements following the 1979 policy changes, coupled with a speeding-up in the making and processing of applications. Our latest assessment is that our bids can be reduced to £474m, £456m and £464m over the three PES years - a reduction of £90m, £107m and £123m from our earlier bids.

8 Against that saving I must make increases in two other bids. The worsening in the prospects of steel suggests that the provision for ISERBS should be increased by £10m in 1983/84 and £5m in 1984/85 (ie above the present bid). The seemingly bizarre insistence by Customs that our support to Research Associations should be subject to VAT could well lead to the costs of our Science and Technology support increasing by £2/3m a year. I should expect such costs to be met by increased PES provision. I must point out, however, that should the VAT rules be applied as rigidly and widely as Customs suggest they might be, then the implications for my Department's programme (and possibly other programmes) would be very considerable.

9 Turning to other individual bids I have been able to find the offsetting savings you have specifically suggested. The bids of £9 million a year arising from changes in the Assisted Areas and a further £2.5 million a year to trigger certain ERDF contributions can be offset by reducing the provisions for the coal-firing scheme (Section 8 of the Industry Act 1972) and by cutting the "wedge" baseline. As already indicated, the costs of the Westlands 30 Helicopter can be offset by the £16m required in 1983/84 by reducing the provision for the English Industrial Estates Corporation (EIEC) by £10m and the provision for spend under various Section 8 schemes by a further £6m. The offsets required in the two later years (totalling £15m) can be found by using the existing provision for Concorde in those years with an additional sum from the wedge baseline. In offering these savings to finance the launch aid for Westlands, you will I know recognize that I have gone further than I believed would be required by last year's agreement. I must also make the point that the reduction in the provision for the EIEC will widen still further the already huge disparity between my building programme for England and those in Scotland and Wales. I must ask you to press for comparable reductions in their building programmes. It is not acceptable that a national project should have to be financed in part by a cut applicable only to England.

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10 The future of the British Technology Group is a special problem and I am not yet in a position to put forward a firm alternative bid. The bids for Science and Technology support should be maintained (and adjusted for VAT developments), though substantial further provisions could prove necessary following the Alvey report on "Fifth Generation Computers". Similarly, I have not altered the bid for a mineral stockpile but I should like to emphasise that while the costs of such a stockpile would fall on my programme the benefits would be widespread.

11 We have looked again at the scope for finding savings to offset the bids we are putting forward but see few realistic prospects. In any event, there is some absurdity, as I have already pointed out, in scratching round in October to find savings only to be offered new money the following April. Nevertheless, RDGs must be considered an option. Last year we discussed changes in RDGs at considerable length without reaching agreement. The arguments against major changes, such as much lower rates of grant, exclusion of sectors or ceilings on grants for large projects, appear just as powerful. I am prepared, as last year, to consider small cuts - perhaps 1% or 2% off the level of grant but I think you will find it difficult to persuade George Younger and Nicholas Edwards to accept even minor cuts.

12 I am copying this letter to George Younger and Nicholas Edwards.

Yours sincerely,

Caroline Varley

PATRICK JENKIN

(Approved by the Secretary of State and signed in his absence)

FROM: A.C.S. ALLAN

DATE: 22 SEPTEMBER 1982

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PS/CHIEF SECRETARY

cc PS/Chancellor
Sir Anthony Rawlinson
Mr Quinlan
Mr Burgner
Mr Lovell
Mr Kemp
Mr Mountfield
Mr Chivers
Mr R H Wilson
Mr Halligan
Mr Rayner

BILATERAL WITH MR JENKIN

.... I attach a draft note of yesterday's bilateral covering DOI's non-nationalised-industry expenditure. I also attach a draft covering letter for you to send to the private secretaries to the other Ministers concerned. I have distributed it directly to the officials in other Departments who were at the meeting, making clear that it is a draft. Sending round drafts of minutes of meetings is not something we would recommend normally, but it seems wise given the misunderstandings last year.

2. I shall be submitting a draft of the second section, on nationalised industries, as soon as I have checked with PE that I have the points recorded correctly.

[A.C.S. ALLAN]

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DRAFT LETTER TO MR JENKIN'S PRIVATE SECRETARY

I attach a draft record of [yesterday's] meeting between the Chief Secretary and your Secretary of State on DOI's public expenditure programme; copies have been sent separately to the officials at the meeting. I should be grateful if you could let me know if your Secretary of State is content. A draft of the second part of the meeting, on nationalised industries, will follow shortly.

2. I am copying this letter and enclosure to [Mr Younger's private secretary], [Mr Edward's private secretary] and [Mr Fletcher's private secretary].

# MINUTES OF A MEETING IN THE CHIEF SECRETARY'S OFFICE

## ON TUESDAY, 21 SEPTEMBER 1982

Present:

Treasury

Chief Secretary
Sir Anthony Rawlinson
Mr Burgner
Mr Mountfield
Mr Chivers
Mr R H Wilson
Mr A C S Allan
Mr Halligan
Mr Gieve

Department of Industry

Secretary of State
Mr T Sharp
Mr Treadgold
Mr Chapman

Scottish Office

Under Secretary of State (Mr Fletcher)
Mr McClellan

Welsh Office

Mr O Rees

DOI PES

Opening the bilateral, the Chief Secretary thanked the Secretary of State for his letter of 13 September; he was grateful for the efforts the Secretary of State made to reduce his bids for RDGs and to produce offsetting savings to match certain specific bids. In his letter, the Secretary of State had suggested that there was an inconsistency between the Treasury's attitude at Budget time and in the PES discussion. The Chief Secretary said he could not accept this. It was necessary for all expenditure programmes to be considered together in PES in the light of the overall objectives set by Cabinet. The Budget was essentially concerned with adjusting taxes, though there were occasionally modest public expenditure changes if the circumstances since the conclusion of the PES round indicated that might be desirable. If the Secretary of State felt that this caused difficulties it would always be possible to have a self-denying ordinance preventing increases in DOI's programmes at Budget time.

2 The Secretary of State said he felt that the Budget increase reflected the general priority which the Government gave to expenditure on industry, and especially to expenditure on innovation and R & D. He felt the same priorities should be reflected in the PES round and that these DOI programmes should not have to be cut back to accommodate increased expenditure elsewhere. The Chief Secretary said that if what was at issue was competing claims for increases in discretionary expenditure then the Secretary of State would of course be free to argue the special merits of expenditure on assisting industry. But he was faced with the need to find savings to match increases in local authority expenditure and in social security payment which were not part of the Government's original plans. He had proposed only very modest cuts in DOI support for science and technology - the 2 per cent cash limit cut proposed for all programmes; the Secretary of State's proposal were for an increase in expenditure over and above that allowed for in the Budget.

3 On offsetting savings, the Chief Secretary said there had clearly been a misunderstanding about what had been agreed last year for launch aid; he regretted this. It would be important to spell out very clearly the terms of any agreement reached this year. The Secretary of State accepted this. He had produced savings to match the launch aid for the WG 30 but only on the understanding that this would not be taken as a precedent for future cases.

Stockpiling strategic minerals

4 The Secretary of State said this bid was only indirectly for his Department, though by convention any expenditure would come from his budget. The pressure came primarily from the Foreign Office, the Ministry of Defence, and the Department of Employment. Ministers collectively had agreed on the desirability of a stockpile

and he was pressing the bid as chairman of E(EA) as well as Secretary of State for Industry. The Chief Secretary said he felt that this bid could not be regarded as of high priority: this was illustrated by the fact that no Department was willing to forgo existing expenditure to make room for financing a stockpile. He could not accept the bid.

5 The Secretary of State said he felt it was important to include at least a modest figure for starting a stockpile; if there then appeared to be some slack in the programme later in the year extra resources could be devoted to it. The Chief Secretary said he was not willing to accept any specific increase in DOI's expenditure provision, but he was ready to agree that if there was a prospect of underspending during the course of a year then DOI could seek to apply those to a stockpile.

Other Selective Assistance

6 The Chief Secretary said this bid was for a miscellany of small changes. He felt the increases must be contained within existing provisions. A variety of schemes had been agreed only on the condition that DOI expenditure did not rise above the baseline. The Secretary of State said he had already squeezed the maximum he felt he could from this programme. He felt this bid must be decided in the context of any agreement on the "wedge".

Scientific and Technological Support

7 The Secretary of State said this was the heart of his Department's support for industry, and its importance had been recognised by the additional provision in the Budget. The Chief Secretary recognised that the additional provision in the Budget provided some argument against the 2 per cent cash limit cut he had proposed; but the Secretary of State was bidding for additional funds on top of what had been provided in the Budget. He was not ready to accept the bid. The Secretary of State said he was not prepared to withdraw it. Only a part of the bid represented increased discretionary expenditure: other parts were to cover the increased cost of privatising the National Maritime Institute and to cover VAT on grants to Research Associations - where the money would flow back to the Treasury in the form of higher tax receipts.

8 The Chief Secretary noted that the bid contained a small provision for expenditure on 'fifth generation computers'. As he understood it, the recent Alvey Report had recommended very large Government expenditure. He felt he should put down a marker that the Secretary of State should not assume that any increased expenditure provision would be available. The Secretary of State said he was

awaiting advice from his officials on the implications of the Report and the action which should be taken.

British Technology Group

9 The Chief Secretary said in his view the BTG should from now on be financed entirely from its own resouces, including disposal proceeds, with no PES provision. The Secretary of State said he was still considering his views about the future of the BTG and was not yet ready to put forward proposals; he had some difficulties with the idea of officials managing a revolving fund. The Chief Secretary agreed that consideration of this should be deferred, provided the Secretary of State brough forward proposals as soon as possible.

Departmental Administration

10 The Secretary of State said he could withdraw this bid provided that he could make use of his wedge provision if it proved genuinely impossible to offset the bid within the provision for Departmental Administration. The Chief Secretar y agreed to this.

Launch Aid

11 The Chief Secretary said that none of the projects proposed for launch aid looked viable; he did not see how he could be expected to agree to any expenditure provision in those circumstances. The Secretary of State said if the projects proved not to be viable he would not proceed with proposals to provide launch aid for them. He had doubts about the A 320 and had told BAe that there must be good prospects of the Government recovering its contribution via the levy on sales; if BAe's proposals did not satisfy that condition he would not accept them. The RJ 500 in turn depended on future of the A 320. He thought the EH 101 had better prospects of being viable than the Chief Secretary had indicated. The up-dated RB 211 depended on the succes of the Boeing 757.

12 After discussion the Secretary of State and the Chief Secretary came to the following agreement:

(i) Projects which were not viable would not be put forward for launch aid;

(ii) For viable projects which were put forward for launch aid the Secretary of State reserved his right to claim on the contingency reserve and contend that he should not be required to find offsetting savings from his programme. There would be no automatic requirement that he should find offsetting savings.

(iii) The Chief Secretary reserved his right to contend that offsetting savings should be found in any such cases. There would be no automatic rule that the Secretary of State should not find automatic savings.

The "wedge"

13 The Chief Secretary said he had sympathy with this bid, but it could only be considered as part of any general agreement on DOI's provision.

BL

14 The Secretary of State and the Chief Secretary agreed that this should be considered in the context of BL's Corporate Plan.

Small Engineering Firms Investment Scheme

15 The Secretary of State said he would be seeing the Chancellor on Thursday, (23 September) and would wish to raise with him the question of re-opening SEFIS. He saw this as essentially a macro-economic measure, providing a short-term investment boost; as such it should be considered in the context of concern about the general health of industry and looked at in the light of developments on interest rates, the exchange rate etc. Re-opening SEFIS would add about £100 million to public expenditure, spread over a number of years.

16 The Chief Secretary said that in his view the propsoal must be considered in the context of DOI's other PES bids. If the Secretary of State's judgement was that more money should be spent on SEFIS then that should be reflected in lower priority for other expenditure. SEFIS was one among many DOI schemes and should not be singled out for special treatment. The Secretary of State said that, following his meeting with the Chancellor (at which the Chief Secretary would be present) he would consider whether to put a bid forward.

'Involuntary bids'

17. The Chief Secretary noted that the Secretary of State had put forward a variety of bids for RDGs, Rolls Royce, assistance to steel and shipbuilding and the ERDF. He was ready to accept these bids: they reflected changing forecasts and there did not appear to be any scope for resisting them. Even with the reduction in the RDG bid, they still totalled £35 million, £99 million and £69 million. This re-inforced the need to look for savings elsewhere. The Secretary of State said part of the bid for assistance to shipbuilding represented higher interest rate assumption promulgated by the Treasury. The Chief Secretary agreed to consider whether the new interest rate assumptions remained valid.

2% Cash Limit Cuts

18. The Chief Secretary said he had proposed 2% cuts in all cash limited programmes. The Secretary of State said he would not agree to the application of this to his science and technology support. He could agree to it applying to the EIEC, but only provided action was taken to reduce the disparity in the levels of factory building in Scotland and Wales compared with England.

Manpower

19. The application of the cash limit cut to Departmental Administration was closely related to the issue of DOI manpower since most of the expenditure was on salaries. Sir Keith Joseph had accepted very substantial manpower cuts for DOI but had reserved his position on returning to the manpower contingency reserve if he found he could not achieve the final cut of 100 posts for which no specific savings had been identified. The position now appeared to be very tight and the Secretary of State said that while he hoped to be able to achieve much of the cut of 100 posts he might not be able to achieve all of it. A cut in the cash limit on departmental administration had to be considered in that light.

20. The Secretary of State said that his investigations into DOI staffing had revealed that the number of people in 'staff' posts - for example those dealing with staff management, pay and allowances - seemed to be grossly out of proportion with the numbers employed in commercial firms of similar size. He did not believe this was a problem isolated to DOI, but extended to most other Departments. Sir Anthony Rawlinson invited the Department of Industry to write to the Treasury setting out these comparisons: the point seemed to be one of general application.

21. The Secretary of State said that he was prepared to accept the 2% cash limit cut on departmental administration provided that it was understood that he could draw on the wedge if it proved impossible to achieve the cut within the programme itself. The Chief Secretary agreed to this.

Other Savings

23. The Secretary of State said that the only other saving he could put forward was a small cut in the rates of RDGs. This was an area of his budget where he felt savings might be made at relatively less cost to industry, but there were, of course, considerable difficulties. The Chief Sècretary said the size of DOI's 'involuntary' bids meant he had to press for whatever savings were available. He recognised that cuts in RDGs would be unwelcome to the Scottish and Welsh Offices, but unless alternatives could be found he would have to propose an RDG cut to colleagues.

24. The Chief Secretary said that one alternative would be to seek cuts in factory building in Scotland and Wales. As the Secretary of State for Industry had indicated, the level of factory building in Scotland and Wales was very much higher than in England - in terms of expenditure per head of unemployed in the assisted areas it was nearly ten times as high in Wales as in England. He therefore proposed cuts of £15 million a year in the budgets of the SDA and WDA.

25. The Under Secretary of State for Scotland said he would wish to consider this in consultation with the Secretary of State for Scotland. He would not wish to see cuts in RDGs, but it could be damaging to cut what was a successful programme of factory building in Scotland: vacancy rates were only about 7%. Mr Rees said he would report the Chief Secretary's proposal to the Secretary of State for Wales. He thought the Secretary of State would see considerable difficulties in the proposal. The level of factory building in Wales had already been cut back from its 1981-82 level. The vacancy rate was 14%, but had been cut over the last few months: this was a major achievement given the amount of new building being completed.

Total Allocation

26. Putting all the various items together, the Chief Secretary said he was prepared to agree to the following compromise:

(i) he would drop his proposal for the 2% cash limit on science and technology expenditure;

(ii) he would agree to the Secretary of State's bid for the "wedge";

(iii) he would agree to half the total bid for science and technology support and for selective assistance (other than stockpiling). This would amount to £10 million, £15½ million and £18½ million in the three years. The Secretary of State would be free to allocate this as he wished, including some provision for a stockpile.

The 2% cash limit cut would be imposed on the EIEC and on departmental administration. The 'involuntary' bids would be accepted. The arrangements for launch aid would be as agreed, and the future funding of the BTG would be left for separate discussion.

27. The Chief Secretary emphasised that this proposal must be taken as a package. If the Secretary of State did not agree to any element of it the Chief Secretary reserved the right to withdraw his offers. He also reserved the right to withdraw the package if the Secretary of State put in a bid for SEFIS. The Secretary of State agreed to consider the Chief Secretary's proposals urgently.

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NATIONAL INSURANCE SURCHARGE

Mr Jenkin's proposals

Mr Jenkin's first priority for industry is a cut in the NIS from April 1983 of at least ½ per cent and preferably 1 per cent.

2. One per cent yields about £1300 million in 1983-84. Assuming clawback from the public sector as in 1982, the net PSBR cost, and the benefit to private industry, would be about £825 million. Of the £825 million - £380 million manufacturing, £120 million other industrial, £80 million financial services, £245 million other services (eg distributive trades).

Points to make

3. You recognise the case for a ½ per cent reduction from next April to prevent the switch back then from the temporary 2 per cent rate to 2½ per cent. To allow for the necessary primary legislation and for the administrative changes, you would have to announce the decision in about November for the change to take effect in April. To concede a full 1 per cent would also require a decision in November - as distinct from deferring the decision on the second ½ per cent until the Budget - unless it were accepted that there would be two changes in the NIS rate in 1983, in April and then in August.

4. You are considering the possibilities but the problems of an increase are considerable:

i. the PSBR costs are substantial and the benefits would be diffused widely going not only to manufacturing industry but also the financial and commercial sectors;

ii. an announcement in November of NIS reductions in 1983-84 would prempt other Budget possibilities, notably those for a reduction in direct taxation beyond Rooker-Wise which could themselves have indirect benefits for industry;

iii. there is the familiar risk of a feed-through to wages and a November announcement could be helpful in this respect.

5. Your decision will also turn in part on :

i. the outcome of the present public expenditure exercise.

ii. the decisions which you will also have to take in November on the NIC and on the share between employers and employees in the increase in the combined rate (see below).

NIC prospects

6. On current prospects for 1983-84 it looks as if we could well be faced with the need to increase the combined rate of contributions by something of the order of 0.5 per cent to 1 per cent, if we are to avoid the Fund going into deficit for the year. The extent of the burden on industry would, of course, depend on how that increase was divided between employers and employees. Even if all the increase was added to the employees' rate, as has been done in the last two years, there would still be a cash increase in the total burden on employers, because of higher earnings and an increase in the upper earnings limit. (The same was the case last year, when the cash increase in employers' National Insurance Contributions burden was expected to be around £640 million (about 7 per cent). And of course the Why Work, poverty trap, etc problem worsens for individuals. Sharing any increase equally (up to recently more usual) reduces these problems but increases the charge on employers.

Legislation - NIS and NIC

7. An early Bill would be needed to consolidate the NIS ½ per cent (or to reduce the rate further). Another early Bill would be needed if the combined NIC rate were to go up by more than 0.5 per cent. The problems involved in two Bills - seeming to point in opposite directions - need to be borne in mind.

8. A fuller note on the timing of an NIS announcement is immediately below.

4/3/82.

PMP

MEETING WITH M. DELORS: NISSAN (DEFENSIVE BRIEF)

BACKGROUND FACTS

PHASE 1 - Pilot plant on stream in 1986

- 24,000 cars per year from imported kits
- direct employment 400 to 500

PHASE 2 - full manufacturing on stream in 1990

- 100,000 cars per year
- initially 60 per cent local content, but 80 per cent by mid 1991
- direct employment 2,700

Nissan will decide on phase 2 not later than 1987. Government selective assistance is £35 million, equivalent to 10 per cent of costs of phases 1 and 2.

Regional Development Grants will also be available.

POINTS TO MAKE

1. We hope that the major gain from the project will be at the expense of imports, which currently supply more than half the UK domestic market.

2. The UK's objective is not to gain employment at the expense of the rest of the Community.

3. Uncertain whether it will increase jobs net in the car and component industries, but it should help make them more efficient and we hope management skills and production technology will spin off to the benefit of the UK and the rest of the Community.

/4.

4. Phase 2 cars will be genuinely European. "Local content" means "local to the EC". It will be a true manufacturing operation on a European cost base in fair competition with other Community manufacturers. Delors should be reassured by the 80 per cent local content commitment. It is not legally binding, but we are confident that it will be observed.

5. We believe this agreement will be important for relations between the European Community and Japan more widely, not just in the field of trade cooperation. The UK has always welcomed inward investment. Openness not protection is the way to keep the EC's industries competitive.

**ANNEX H**

SMALL ENGINEERING FIRMS INVESTMENT SCHEME

Mr Jenkin is likely to press hard for the re-opening of this scheme: his letter of 13 July asked for an allocation of £100 million.

2 This scheme was introduced soon after the Budget but attracted such a flood of applications it had to close soon by the end of May. It provided grants of $33\frac{1}{3}$ per cent for small firms investing in certain advanced technology capital equipment such as computer controlled machine tools. In the $8\frac{1}{2}$ weeks it was open it attracted 1750 applications, and DOI increased their funding from £20 million to £30 million.

... 3 The attached note by DOI summarises their views on the effects of the scheme. It does seem to have encouraged small firms to invest in high technology equipment, but it is inevitably difficult to assess just how much genuinely additional investment has been stimulated. One point to note is that 60 per cent of the equipment purchased is made abroad - this is less favourable than indicated in Mr Jenkin's letter, when he said over 60 per cent of the orders were for British equipment.

4 There could be no objection to Mr Jenkin re-opening the scheme if he was able to find the resources within his existing PES provision. But Mr Jenkin already has some substantial PES bids in, and the £100 million be seeks for SEFIS is intended to be additional to that. It seems impossible to divorce the bid for SEFIS from his other bids and from the Public Expenditure Survey generally: indeed in your reply to Mr Jenkin of 14 July you said that "so far as measures which will involve public expenditure are concerned these must I think be considered in the context of the current PESC round".

5 We therefore recommend that you re-affirm this line to Mr Jenkin. The bid for SEFIS will be considered alongside his other bids: if he attaches very high importance to it it is up to him to reduce his other bids and find the savings necessary to accommodate it.

SMALL ENGINEERING FIRMS INVESTMENT SCHEME (SEFIS)

A REVIEW NOTE BY THE DEPARTMENT OF INDUSTRY

## The Scheme

SEFIS made available grants of $33\frac{1}{3}\%$ to small engineering firms to assist in the acquisition of certain types of advanced capital equipment. An original allocation of £20m was quickly exhausted and a further £10m only provided enough funds to keep the Scheme open for $8\frac{1}{2}$ weeks. In that time 1752 firms had applied for assistance.

Most applications have now been processed and over 1200 offers of assistance have been made. The final committment is likely to be very close to the full £30m allocation. Already 95 projects have been completed and payments of £1.2m made.

The early closure generated many calls for an early re-introduction of the Scheme. These have come not only from individual firms but from the House of Commons and from almost all of the engineering industry representative bodies.

## The Effects

Almost all of the anecdotal evidence has suggested that SEFIS has given a significant boost to investment in the small engineering sector, which has been at a very low level. It was our intention to direct this investment into the advanced NC or CNC equipment which is widely recognised as being a crucial element in future competitiveness. A sample survey of successful applicants carried out by the Department suggests that this objective has been achieved. 51% of respondents claim that this represents the first occasion on which they have acquired NC or CNC equipment. The Department is also confident that many of these investments would not have gone ahead without support under SEFIS. 89% of respondents to the survey claimed that they would not have invested at the present time and 54% also claim to be using the assistance to acquire a more advanced machine than they would otherwise have considered. Any survey is open to question and it is impossible to be certain that this one represents an accurate picture. However other indications tend to confirm this impression and it should also be remembered that the average size of project of £66,000 represents a major investment for a small firm. In the case of SEFIS, many of the applicants were so small that 75% employed fewer than 50 employees.

The number of imported machines specified in applications is disappointing although in line with a typically high level of import penetration in the machine tool sector. Only 41% of machines on which offers have been made are of UK origin. In the absence of outright protectionism it is difficult to visualise any improvement in this performance by the domestic sector because of well established Japanese dominance of the market.

The Department concludes that SEFIS achieved almost all its modest aims in stimulating small firms to invest in technologically more sophisticated machinery before they would otherwise have done so. The indications are that installations are currently being made and that a considerable unsatisfied demand still exists. Any fresh scheme could draw on the experience of the original to make some amendments which would target the money more accurately. However, the basis and much of the detail of the original SEFIS would be best left unchanged in order to combine the the maximum benefit to industry with the administrative economy which was a feature of the Scheme.

MEE 3
Department of Industry

14 September 1982

DEFERMENT OF REGIONAL DEVELOPMENT GRANTS

Mr Jenkin proposes ending the four-month deferment in payment of regional development grants. This would cost £140 million once-for-all. The proposal is, as we understand it, to end deferment in this financial year, when Mr Jenkin is likely to be underspending his programmes somewhat and so could afford to accommodate a proportion (but not all) of the cost within his existing provision.

2 There are advantages in getting rid of this unattractive administrative delay. Doing so would provide a once-for-all benefit to the cash-flow of industry in the Assisted Areas. And it would have little, if any, monetary effect since at present firms normally borrow from banks on the strength of an RDG offer-letter.

3 But we suspect that Mr Jenkin may not in fact press this very hard, feeling that ending deferment is not a very high priority; if £140 million additional public expenditure could be accommodated this year there may be other more attractive measures which could be adopted. Although the four-month delay is a continuing irritant, firms have by now largely become inured to it.

4 We therefore recommend you to note Mr Jenkin's proposal, but to say that any decision will have to be delayed until the outlook for public expenditure and the Contingency Reserve for this year is clearer.

AID AND TRADE PROVISION (ATP)

It is not certain from the correspondence that the Industry Secretary will raise this. If he does not, we would not recommend you to do so. Although both the Trade and Industry Secretaries have been suggesting that the ATP should be further increased, there is no PES bid on the table at the moment and we would not want to provoke one.

2. The ATP is part of the Aid Programme. During recent discussions on the composition of the Aid Programme, ODA originally proposed that the ATP should remain at the 1982-83 level of £55 million throughout the PES period to 1985-86. In response to DOT and DOI pressure this has now been increased to £66 million from 1983-84 onwards.

3. If the Industry Secretary does raise it, we suggest you use the following arguments:-

a) The ATP has already been increased by 20 per cent in response to DOI/DOT arguments. The Foreign Secretary, whose programme it is, is not prepared to find any more.

b) You are concerned about the scale of our export subsidies for capital goods. In many cases the subsidy required is so high that the contracts are not worth winning. This is a very expensive way of preserving or creating jobs. Part of the benefit goes to overseas purchasers. Part of the capital goods industry is coming to depend on subsidy for its continued existence.

c) The Prime Minister has recently asked for a note on how to limit the growth of subsidised export credit and the escalation of

competitive export subsidies.

d) The recent report of the Foreign Affairs Committee was critical of the way the ATP is being used and suggested that it should be confined to 5 per cent of our total bilateral aid - which would mean reducing it to £33 million a year.

e) It is not therefore the time to be suggesting a further increase in the ATP. If the Industry Secretary nevertheless wished to pursue it, the public expenditure situation is such that he or the Trade Secretary would have to find offsetting savings from their programmes.

INDUSTRIAL RATES

Mr Jenkins does not ask for any action to be taken on industrial rates, although the CBI continue to call for a measure of industrial derating. Misc 79, of which Mr Jenkins is a member, has decided against including industrial derating in the package of rate reforms which it is recommending should be announced in the next session.

2. The Interdepartmental Official Group on rating reform concluded that the minimum worthwhile relief would be 10% (16p). This would cost about £140 million for industrial rates alone and £700 million for non-domestic rates as a whole.

3. Industrial rate relief would require legislation. This could not be in a Finance Bill and there is no other suitable bill currently on the stocks for the 1982-83 session. In order for industrial derating to become effective in 1983-84 room would have to be found for a shortish bill early in the session. Failing that, implementation could not be earlier than the beginning of the 1984-85 session. About 6 months preparatory work would be needed by the Valuation Office and during this period the Inland Revenue would require about 100 staff.

TAX RELIEF FOR SMALL BUSINESSES

The CBI sent you on 29 July, with a copy to Mr Jenkin and other Ministers, a paper proposing the setting up of Small Firms Investment Companies to facilitate investment by individuals and by financial institutions in smaller companies both new and established. Tax concessions similar to those in the Business Start-Up Scheme would apply but we cannot yet put a cost on them. DOI Ministers are said to be sympathetic to this, and Mr MacGregor enthusiastically so.

2. The present position is that the Treasury, with FP leading, have opened up interdepartmental discussions with DOI and others. On 22 September the interdepartmental team will meet with CBI representatives to go through the proposals. We will then put a provisional report to you.

3. For the moment, we have yet to be convinced that there is a firm case for going beyond the BSUS which, as you know, was firmly based on the assumption that the priority was to encourage the provision of relatively small amounts of risk capital at the start-up stage when businesses had no track record. We have to be persuaded that established small businesses are now having difficulties in finding access to equity and that the problems of investment in small firms are such as to justify the setting up of SFICs with attendant tax concessions. But although we have these doubts we are very much open to persuasion and we have told DOI, and will tell the CBI, that we would welcome firmer evidence of their case.

4. Quite apart from any question of a major extension of tax relief for small businesses, questions are coming up about the rules surrounding the present BSUS. We and the Revenue will be looking at these as part of the Budget starters exercise.

ANNEX M

CIVIL ENGINEERING WORKS

Mr Jenkin suggests there is scope for a stimulus to the Civil Engineering side of the construction industry; the CBI have also pressed for additional public capital works. And CPRS have similar ideas in their big Report on Unemployment.

2. Obviously no one can have anything against public capital works as such. They can provide a stimulus to the economy and give a help with unemployment (with relatively low import penetration); and the works themselves of course usually have economic or social worth once created. But the money to pay for them must be found within existing fiscal strategies, and in particular within public expenditure totals. If Mr Jenkin can help in the Chief Secretary's efforts to switch from current to capital spending within existing totals, this would be very welcome. In relation to demand and unemployment, however, two points need to be borne in mind; first there is often a long lead time before decisions to proceed with a given construction actually has any real effect (plans do not often exist ready-made on the shelf and there are often constraints such as planning enquiries and the like); and secondly seen purely as employment creation some capital works can have a much higher cost per job than other measures.

3. There was of course a "construction package" included in the last Budget, principally additional money made available for improvements in insulation of private houses.

Results of the Public Expenditure Bilateral with

Mr Jenkin, 21 September 1982

A record of the meeting is in preparation and we hope to have a draft available by this evening but this is a quick note of the main points relevant to the Chancellor's 23 September meeting with Mr Jenkin. The Chief Secretary will attend.

2 The Chief Secretary agreed involuntary and inescapable bids totalling:

| 1983-84 | 1984-85 | 1985-86 |
|---|---|---|
| | | £ million |
| + 35 | + 99 | + 69 |

He accepted that the only savings attainable were 2 per cent cash limit cuts on factory building and administration:

| | | |
|---|---|---|
| - 2 | - 2 | - 2 |

He offered additions to cover Mr Jenkin's bids for stockpiling minerals, selective assistance, science and technological assistance and VAT of:

| | | |
|---|---|---|
| + 10 | + 15 | + 18 |

and a topping up of the DOI's unallocated "wedge" of

| | | |
|---|---|---|
| + 6 | + 4 | + 5 |

3 This means total net additions of:

| | | |
|---|---|---|
| + 49 | + 116 | + 90 |

which compare very favourably with Mr Jenkin's bids (themselves much scaled down since July) of:

| | | |
|---|---|---|
| 214 | 320 | 268 |

4 However, there are other liabilities around. The Industry Secretary will want to pursue his bid for the British Technology Group (NEB/NRDC) when he has





)y in relation to that body, which is currently under review.
quire £100 or £150 million in 1983-84: a decision to be taken
82 Corporate Plan in November. And although Mr Jenkin
for the present his large bids for launch aid for aerospace
e well to earmark perhaps £30 million to £50 million a year
reserve against the probability that he will in due course
such support to the aircraft and aero-engine industries.

t which Mr Jenkin will want to follow up is SEFIS, on which
ief is attached. **(See Note H).**

not formally bid for SEFIS in the Survey, though he is asking
er 3 years to reactivate the scheme.

retary pressed Mr Jenkin on why he regarded it as a matter
the Chancellor on 23 September rather than a public
e all the others. Mr Jenkin was not very coherent about this:
as a means of reflating the economy - as though it were to be
onal public expenditure over and above the planning total.
investment going again and restoring confidence in industry,
have a psychological effect out of proportion to the amount

retary said that he could not see that SEFIS was qualitatively
r Industry schemes; it was not really a macro-economic measure,
e of the expenditure was relatively modest. It had undoubtedly
heme, but if Mr Jenkin wanted to make it one of his priorities
place among his regular expenditure bids.

retary said that if Mr Jenkin bid for extra money for
g with the Chancellor he would re-open the agreement that
his other bids.

recommend the Chancellor to argue against SEFIS on merits,
ort content (almost 60 per cent) is worrying, and the very
es one suspicious about additionality: if firms are so keen
pects that it involves paying them for what they would have
anyway. But there is no case for considering it outside the
Survey: it is just like the other Section 8 or Science and
nes like those to encourage firms to introduce micro-processors,

robots or flexible manufacturing systems. And expenditure of £30 or £40 million a year, half of it going abroad, is really not relevant in the macro-economic context.

Budget management

11 Mr Jenkin also became heated about the problem (mentioned in his letter of 13 September to the Chief Secretary) that the Treasury has in two successive years given him a little extra in the Budget only to take it away in the Survey. He argued that if, as was evidently the case, industry was a recognised priority of the Government, this ought to be reflected in his treatment in the Survey.

12 Points you could make if he reverts to this are:

(i) The policy has not been inconsistent: one's judgement changes from forecast to forecast, and it is perfectly reasonable to superimpose short-term adjustments on the underlying long-term public expenditure framework determined in the Survey.

(ii) The amounts of DOI expenditure involved in the Budget have been very small (£100 million over 3 years in 1982) and not enough to upset DOI's programming.

(iii) There can be no question of exempting DOI from the Survey: that being so, this is a pragmatic way of showing a degree of favour to the Industry programme.

(iv) In any case (you could say) the Chief Secretary seems to have let the Department of Industry off extremely lightly in the current Survey in agreeing to net programme increases of around £100 million a year.

KIT CHIVERS

SELECTED KEY DATES - PROVISIONAL

| | |
|---|---|
| October 7 | Autumn forecast to Treasury Ministers, followed by papers on fiscal policy and options. |
| October 21 (or 28) | Economic and public expenditure papers circulated to Cabinet |
| October 28 (or November 4) | Economic Cabinet |
| November 4 (or November 11) | Possible spill-over Cabinet |
| November 24 | Autumn Statement published [This is very provisional. The gap between final Cabinet decisions and publication of the AS is elastic and could be longer or shorter depending on the detail and elaboration wanted for the AS. The lead time of 20 (or even 13) days implied in the tentative date of 24 November could be shortened]. |

A more detailed note on the timetable is going forward separately.