2. Part A.

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Begins: 23/1/81
Ends: 2/4/81.

PO -CH /GH/0079

PART A

Chancellor's (Howe) Papers:

INFORMAL FINANCE
MINISTERS MEETING THE
NETHERLANDS APRIL 1981

Disposal Directions: 25 Years.

26/7/95.

PO -CH /GH/0079
PART A

CONFIDENTIAL

CH/EXCHEQUER
REC. 23 JAN 1981
ACTION Mr Edwards
COPIES TO CST
FST
Sir D. Wass
Sir K. Couzens
Mr Monck

Mr Hancock
Mr Middleton
Miss Hedley-Miller
Mr Lovell
Mr Unwin
Mr Ridley

23/1/81

1C

PM/81/2

PRIME MINISTER

I am anxious lest the 'softly softly' approach should end the game before it starts!

Restructuring the Community Budget

1. When we discussed this in OD last October, we agreed that officials should have exploratory discussions with other Member States and with the Commission. I attach a progress report which has been prepared by the Cabinet Office in consultation with officials from the Foreign and Commonwealth Office, the Treasury and the Ministry of Agriculture.

2. I suspect that we have done as much homework on this as anyone and we need to be careful not to rush things in what will undoubtedly be a protracted negotiation. We shall not achieve our objective in getting the problem looked at as one for the Community as a whole if we are seen to be trying to make too much of the running. The French are in any case going to play the whole exercise down before the Presidential elections. But there are things which we can do behind the scenes and your forthcoming meeting with van Agt will be an opportunity to ensure that the Dutch Presidency keep up the pressure. The report by officials also suggests that we should now begin to develop the argument that the Community budget should have a redistributive function; and try out some ideas on the Germans and the Commission services. This will need to be handled carefully but I agree that we should try to push things forward in this way.

3. If you agree, I suggest that the report should be circulated to our colleagues in OD, but I would not myself

/have

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have thought that further collection discussion at this stage was necessary. In the meantime, I am sending copies of this minute with copies of the paper to the Chancellor of the Exchequer, the Minister of Agriculture and Sir R Armstrong.

C

(CARRINGTON)

Foreign and Commonwealth Office

23 January 1981

RESTRUCTURING THE COMMUNITY BUDGET: PROGRESS REPORT

1. When OD considered the Note by the Secretary of the Cabinet (OD(80) 57) at their meeting on 13 October (OD(80) 20th Meeting) they agreed that exploratory bilaterial contacts on budget restructuring should proceed. This note reports on the outcome of those contacts and on other relevant developments since October.

2. A list of the meetings during which there has been discussion of budget restructuring and/or reform of the Common Agricultural Policy (CAP) is at Annex 1.

3. The outgoing Commission put in hand certain basic studies but recognised that the formulation of proposals would have to be taken up by the new Commission. Mr Thorn and his colleagues can be in no doubt that the restructuring mandate represents one of their most important and immediate tasks. The Dutch, who are in the Presidency for the first half of 1981, are urging the Commission to present their proposals under the 30 May mandate in time for discussion at the European Council at the end of June.

4. The general presentation we have given of our approach to budget restructuring, in accordance with the line agreed by OD, has been listened to with interest and with some support. We have been careful to avoid giving the impression that we already have cut and dried solutions of our own. Nevertheless, there have been some encouraging developments -

a. The firm support of both Germany and France - reiterated by President Giscard at the last European Council meeting - for the maintenance of the present limit of one per cent on VAT contributions. While other countries are not willing to endorse the one per cent ceiling as an aim in itself, there is a realistic understanding that the Community will have to learn to live with existing own resources at least for the time being. This was also recognised by Mr Roy Jenkins but it remains to be seen whether the new Commission will be content to put forward proposals which are compatible with the ceiling or whether they will wish to indicate the conditions under which, in their view, an increase in the ceiling would be justified;

b. the announcement of the new German Coalition Government that, after 1981, the rise in expenditure on the Common Agricultural Policy (CAP) should be markedly less than the rise in own resources. In the immediate future, we are hoping to secure German support for laying down an effective financial ceiling within which the 1981 decision on agricultural prices and related measures will be taken. In bilateral discussions we shall indicate our broad support for the German ideas for imposing a financial limit on the growth in the CAP in the longer term. We have to keep in mind however that the Germans would accept in order to reduce the budgetary cost of the CAP, co-responsibility levies and economies of types which would not be in the United Kingdom's interests.

c. The approach of the 1 per cent ceiling and the prospects of enlargement are forcing all member states to face up to restructuring seriously.

5. Less satisfactory have been French attempts to block other Community decisions, especially external trade, in advance of the restructuring exercise. They have argued that until the Community has completed its discussions especially on the CAP it is not possible to enter into long-term commitments eg on New Zealand butter or agricultural imports from Cyprus. It remains to be seen whether their primary motive is to avoid difficult decisions before the French Presidential elections or whether the linkage with budget restructuring will prove a continuing obstacle. Conversely, the French are anxious for a satisfactory settlement of 1981 CAP prices before their elections whereas our aim must be a settlement which, having regard to the interests of our own industry, is consistent with our longer-term objectives for restructuring and CAP reform. The Commission agreed in December a paper setting out ideas for CAP reform. Some of these are unhelpful to the United Kingdom and we have commented on them as well as on the price level to be proposed for 1981.

6. While everyone is a long way from admitting it in public, our exploratory bilateral talks have shown a growing realisation that reform of the CAP and the development of alternative Community policies will not, by themselves, be sufficient to prevent the recurrence of an "unacceptable budgetary situation" for the United Kingdom, and certainly not by 1982. We have been careful not to stress this conclusion ourselves but to allow it to emerge from a realistic assessment of what can be done within the 1 per cent ceiling. The reluctance of others to admit it stems from -

i. strong dislike among the smaller member states of the Schmidt/Giscard idea for limits on net contributions and benefits; and

ii. the realisation that, to do so, would mean admitting that Community policies were not capable of producing an acceptable budgetary situation for all member states.

7. As regards i. the German Chancellor made it clear to the Prime Minister that he is still greatly interested in the idea of limiting net benefits as well as net contributions although his officials have so far refused to discuss it. Predictably, large net beneficiary countries have made it clear that they see little justification for such limitations. The objection at ii. is clearly one which we are going to have to overcome sooner or later. The Community cannot totally ignore the budgetary consequences of its policies which at present have a random and often perverse effect. Having got the Community at long last to recognise that there is such a thing as an "unacceptable budgetary situation" we now need to take the Community's thinking on to a further stage of consciously deciding what the redistributive effect of the budget should be.

8. Officials have therefore considered ways in which the budgetary position of member states could be adjusted on logical principles and not simply by way of arbitrary corrections of the kind discussed in the report by officials attached to OD(80) 57 (paragraphs 57-63). Two approaches are envisaged both of which start from the premise that the pattern of distribution between member states emerging from the present budget arrangements needs to be changed; both are also compatible with the maintenance of the 1 per cent VAT ceiling.

9. The first - which we call the <u>objective budget approach</u> - involves comparing the actual distribution of contributions and benefits with an "objective" distribution which would reflect relative prosperity. The latter would represent a long-term target for the Community to aim at. In the meantime while the necessary changes in policies were taking place, a partial adjustment would be made to bring net contributions and benefits closer to the "objective". The extent to which the actual distribution would be adjusted towards the long-term objective could be decided, say, for a period of three years at a time (although the amount of adjustment necessary would have to be worked out annually). A problem with this approach is the substantial scale of transfers which could be required after enlargement to the poorer countries, particularly Spain.

10. Another approach - which we call the <u>two budget approach</u> - would involve splitting the budget in two: a "central budget" financing CAP guarantee expenditure, industry, energy, research and administration. This would be made distributionally neutral between member states ie each would get out as much as it contributed; and a "structural budget" for expenditure intended to promote economic convergence like the Regional and Social Funds, FEOGA guidance expenditure and the EMS interest rate subsidies. The distribution of expenditure under the structural budget would be consciously decided at the outset, fixing the net amount by which member states with below average GDP would benefit, thus enabling the cost of enlargement to be contained. There would be a transitional period moving from the post-30 May situation, to a pre-determined level of net contributions and benefits under the two-budget approach.

11. Tables illustrating these two approaches are at Annex 2. The figures are not definitive but both approaches are of course capable of achieving the objectives which Ministers have laid down. Anticipating future negotiations, they assume that the United Kingdom might actually end up as a net beneficiary.

12. Both approaches could serve to direct discussion on to the proposition that the redistributive effects of the Community budget as a whole should be willed as a matter of policy rather than resulting from the chance outcome of the cumulative effect of individual policies. Our purpose in exposing these ideas is a tactical one, to start a train of thought in the minds of others which would be helpful to us when the substantive negotiations begin. At this stage we would not wish to go too far in exposing these ideas and run the risk of arousing adverse reactions. Moreover there are in any case problems such as the scale of budgetary transfers required and the risks of trade diversion by member states trying to offset the loss of their present budgetary benefits. But we consider it would be worth exploring our ideas with the staff of the Commission, who have already expressed some interest in our ideas on budget adjustment mechanisms, and with the Germans as a means of encouraging them to develop their own thinking on the subject. Only in the light of their reactions would it be sensible to consider carrying the discussion forward with other member states. In the meantime however we should certainly try to persuade other member states of the view that the overall distributive effects of the budget must be a matter of conscious Community policy.

Cabinet Office
January 1981

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ANNEX 1

BILATERAL CONTACTS ON BUDGET RESTRUCTURING

| Date | Country | Department | Level |
|---|---|---|---|
| 16 Oct | Germany | MAFF | Official |
| 27 Oct | President elect Thorn | PM/Foreign Secretary | - |
| 30 Oct | Netherlands | MAFF | Ministerial |
| 31 Oct | Germany | FCO/Cabinet Office | Official |
| 6 Nov | France | FCO/Cabinet Office | Official |
| 16/17 Nov | Germany | Prime Minister | - |
| 18/19 Nov | Greece | FCO/Cabinet Office | Official |
| 19 Nov | Ireland | MAFF | Official |
| 23/24 Nov | Italy | Prime Minister | - |
| 24 Nov | Commission | FCO | Official |
| 26 Nov | Belgium | FCO | Official |
| 2 Dec | Greece | MAFF | Ministerial |
| 4 Dec | Denmark | MAFF | Official |
| 5 Dec | Netherlands | FCO | Ministerial |
| 11 Dec | Italy | FCO/Cabinet Office | Official |
| 17 Dec | Denmark | FCO | Ministerial |
| 17 Dec | Netherlands | FCO | Official |
| 19 Dec | France | FCO | Ministerial |

TABLE 1: OBJECTIVE DISTRIBUTION OF NET BUDGETARY CONTRIBUTION (-) AND RECEIPTS (+) (See paragraph 11)

MEUA

| | Unadjusted net contribution to allocated expenditure | Position after 30 May agreement | Possible intermediate stage (25% of Col 1 + 75% of Col 5) | Objective distribution: for Community of 10 | for Community of 12 |
|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) |
| Germany | -1350 | -1900 | -1050 | - 815 | - 965 |
| France | NIL | - 400 | - 400 | - 395 | - 535 |
| Netherlands | + 550 | + 450 | + 45 | - 85 | - 125 |
| Belgium | + 600 | + 500 | + 70 | - 70 | - 105 |
| Denmark | + 550 | + 500 | + 80 | - 60 | - 75 |
| Luxembourg | + 300 | + 300 | + 70 | - 5 | - 10 |
| Italy | + 850 | + 650 | + 665 | + 770 | + 605 |
| UK | -2150 | - 750 | - 355 | + 400 | + 245 |
| Ireland | + 650 | + 650 | + 195 | + 60 | + 45 |
| Greece | NIL | NIL | + 125 | + 200 | + 165 |
| Spain | na | na | + 395 | na | + 525 |
| Portugal | na | na | + 170 | na | + 230 |

Notes: Column 1: From Commission estimates for 1981

Columns 4 and 5: Distribution obtained from formula: Net position = Budget x Population share x (1 - GDP per head as percentage of Community average) ÷ 2

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TABLE 2 : DUAL BUDGET APPROACH : ILLUSTRATIVE EFFECT OF CENTRAL AND STRUCTURAL BUDGETS COMBINED*

NET CONTRIBUTIONS (-) AND RECEIPTS (+) OVER TRANSITIONAL PERIOD

MEUA

| | 1981 | 1982 | 1983 | 1984 | 1985 | 1986 / |
|---|---|---|---|---|---|---|
| Germany | -1900 | -1650 | -1400 | -1335 | -1145 | -955 |
| France | - 400 | - 420 | - 445 | - 575 | - 635 | -695 |
| Netherlands | + 450 | + 340 | + 230 | + 90 | - 35 | -155 |
| Belgium | + 500 | + 380 | + 265 | + 125 | - | -125 |
| Denmark | + 500 | + 390 | + 280 | + 160 | + 50 | - 65 |
| Luxembourg | + 300 | + 240 | + 180 | + 115 | + 55 | - 5 |
| Italy | + 650 | + 680 | + 710 | + 740 | + 770 | +800 |
| UK | - 750 | - 540 | - 330 | - 120 | + 90 | +300 |
| Ireland | + 650 | + 550 | + 450 | + 350 | + 250 | +150 |
| Greece | nil | + 30 | + 60 | + 90 | + 120 | +150 |
| Spain | na | na | na | +180 | + 240 | +300 |
| Portugal | na | na | na | + 180 | + 240 | +300 |

*excluding aid

/ This postulated final composition of the structural budget is assumed to be a political decision, but taking account of member states' relative prosperity and population size, and their non-budgetary resource transfers. Alternatively the global sum of net benefits could be decided at the outset, but with the precise distribution allocated according to a formula.

26/1/81. 10B

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CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir D Wass
Sir K Couzens
Mr Ryrie
Mrs Hedley-Miller
Mr Edwards
Mrs Lomax
Mr Thomson

Ok - does the minute do full justice to this cover note?

RESTRUCTURING THE COMMUNITY BUDGET

1. The Foreign Secretary's minute to the Prime Minister dated 23 January covers a report by officials prepared after consultation with the Treasury on the progress of the exploratory talks we have been having with other Member States and the Commission about restructuring the Community Budget. It is partly a factual account of what has happened to date and partly intended to check that Ministers have no objection to our developing the negotiations in one particular respect. The Prime Minister has responded quickly - see Mr Alexander's letter of 26 January on which I comment below.

2. In the report we put to Ministers last October, OD(80)57, we described a couple of schemes for "direct adjustment systems" which would give substance to the ideas tentatively put forward by the Germans and President Giscard for placing limits on the net contributions and net benefits of all Member States. The idea, roughly speaking, was that anyone who paid too much or received too little would make or receive a direct cash transfer outside the normal operation of the Budget to correct the imbalance.

3. Our ideas have developed since last October in three respects:-

(i) We have realised that, although the direct adjustment systems described to Ministers in the October report would create a vehicle for making permanent an arrangement on the lines of the 30 May settlement, such a system would provide no dynamic which would ensure a steady improvement in the UK's net position. Even after the 30 May agreement, we are still the second largest net contributor to the Community Budget although one of the poorer Member States. In addition, we have to pay prices for food imported from the rest of the Community which are above world prices.

(ii) We have studied the costs of the accession to the Community of Greece, Spain and Portugal, and have identified a real threat to UK interests - namely that the UK will be expected to bear part of the extra cost of this enlargement in addition to the net burden negotiated on 30 May.

(iii) But it has also become apparent that enlargement contains a major threat to the interests of Germany and France which might make them more sympathetic to radical ideas.

4. The result is the ideas described in paras. 9-11 of the officials' report. Their essential characteristic is that they require the Community to reach an agreement on what would be fair levels of net contributions to and benefits from the Community Budget by individual Member States taking account of relative prosperity, population and (if possible) resource transfers through the operation of the CAP. Our ideas recognise that it would not be possible to move to such a distribution straight away but that some form of transitional period would be required.

5. We do not have very high hopes of negotiating agreement to ideas of this sort, which would represent a very radical departure from established Community ideas. On the other hand, it would be so clearly in the UK's interest to succeed in this endeavour that it would be foolish not to try. And we have plenty of time - the negotiations with the other Member States are not expected to start until the second half of this year after the Commission have tabled their June report.

6. Experience shows that one has to be very careful in launching new ideas in the Community. If we push too hard or too fast we risk provoking the other Member States into refusing to discuss the ideas at all. The suggestion in the officials' report is therefore that we should try out our ideas very interrogatively on the Commission and on the Germans. It is important to influence the Commission because the content of their June report will be the framework within which the subsequent negotiations will take place. Among the other Member States it seems obvious to start with Germany, because they are even more at risk from enlargement than ourselves and also because Chancellor Schmidt

told the Prime Minister in November that his Government would be arguing for a ceiling on all net contributions and a ceiling on all net benefits.

7. Recently there have been indications that at least some officials in the Commission are thinking of solving the Budget problem by some scheme for differential national financing of the CAP. We have only just go wind of this and are beginning to analyse that approach to see whether we could turn it to our advantage. We are also working on a number of fall-back positions so as to have them ready for deployment if our preferred ideas do not find favour. These include:-

(i) An improved version of the type of scheme limiting net benefits and net contributions described in the October report.

(ii) A deficiency payments scheme for cereals in the UK, modelled on the lines of the regime agreed for sheepmeat. (The idea is that we might deploy such a scheme if both the discussions on restructuring and the discussions on the reform of the CAP look like leading nowhere.)

<u>Prime Minister's comments</u>

8. Mr Alexander's letter of 26 January records the Prime Minister's view that we should beware of suggesting that the Community Budget should have a "redistributive function". This is a reference to a rather ill-chosen phrase in the Foreign Secretary's minute. In fact, the Community Budget and the CAP do redistribute resources between the Member States now but they do so in an arbitrary way with (in our case) perverse consequences. Our aim should be to get the Community to recognise that the redistributive consequences of the Budget should be based on defensible principles. It is also an explicit purpose of the "two budget" scheme described in para. 10 and Table 2 of the officials' report to place an agreed limit (consistent with the 1% ceiling) on the amount of redistribution that takes place.

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Recommendation

9. I recommend that you endorse the proposal in the officials' report. A draft minute to this effect is attached. It has two other purposes:-

(i) to make the point in para. 8 above; and

(ii) to remind other Ministers that there is a lot at stake and we cannot afford to be complacent about our negotiating aims. (At times, perhaps unjustly, we suspect the FCO of desiring a peaceful settlement of the issue more than a good bargain for the UK.)

D.H.

D J S HANCOCK
26 January 1981

A

cc: Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr. Ryrie
Mrs. Hedley-Miller
Mr. Hancock
Mr. Edwards
Mrs. Lomax
Mr. Thomson

CONFIDENTIAL

P 27/1/81.

14A

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

PRIME MINISTER

RESTRUCTURING THE COMMUNITY BUDGET

I refer to the Foreign Secretary's minute to you of 23 January covering a note by officials on progress with the exploratory discussions so far and proposals for the next steps. I have seen your comments recorded in Mr. Alexander's letter of 26 January.

2. I support the proposal in the officials' report that we should now begin to develop our ideas discreetly with Commission and German contacts. The chief idea we need to get across, as I see it, is not so much that the Community Budget should "have a redistributive function" but rather that the redistributive effects of the Budget (which already exist - and operate to our disadvantage) should be planned on defensible criteria and not allowed to result haphazardly from the particular effects of specific policies as at present.

3. This means that I very much agree with the implication of your comments: namely that a strict limit should be placed on the amount of redistribution that is allowed to take place - and the 1 per cent VAT ceiling can be called to our aid for this purpose. But it is also of special importance to the UK interest that the Community should accept that the redistributive effects of the Budget should not be perverse as, in our case, they are at present. It ought to be an aim

/of our efforts

of our efforts on restructuring to avoid being left permanently as the second largest net contributor of the Community Budget. Given our relative wealth and the size of the resource transfers we make as a net importer of food, that would over the years become increasingly difficult to defend to opinion at home.

4. Although I agree with the Foreign Secretary that we should be careful not to rush things and thus risk provoking a premature rejection of radical thought, I also think it essential that we should not under-estimate the strength of our position. The reaction of Germany and France to the redistribution to them of part of our budgetary burden, the prospective financial and economic impact on them of enlargement and perhaps also the effect on German policy of their balance of payments problem could mean, taken together, that they will not necessarily rule out a radical reappraisal of present arrangements.

5. We shall have to take stock again when we have made what progress we find possible with our selected German and Commission contacts. However, I think it must be right to make it clear to the Commission and our partners at the right moment, as one element in the negotiations, that, although we accepted the 30 May agreement in a spirit of compromise for a two or three year period, we still remain, even with that agreement, more disadvantaged relative to our GNP per head than any other member of the Community: a burden we ought not to be asked to accept as a permanent feature of Community life.

6. I am sending copies of this minute to the Foreign Secretary, the Minister of Agriculture, Fisheries and Food and Sir Robert Armstrong.

R I Tolkien

, for,

(G.H.)

(Approved by the Chancellor and signed in his absence)

27 January 1981

BRIEF 2

NO.2

30/3/81.

15

No.2

DEVELOPMENT COMMITTEE

Line to take

The suggested draft agenda of the Development Committee meeting on 22 May is broadly satisfactory to us. We will be proposing a number of changes when the draft is discussed at the IBRD Executive Board, particularly on the section on the proposed energy affiliate, on which the UK has reserved its position.

2. As far as the proposed new Task Force on Concessional Flows is concerned (Item 4), we have told Ibarra that we have no objection to the establishment of the Group.

3. We have not decided about British participation. There are risks in setting up yet another international body which could become a forum for criticism of countries' aid performance, and tend to polarise attitudes in the Development Committee on United Nations lines. We do not yet know whether the Americans intend to participate; this will be a factor to be taken into account. We also need to know more about the terms of reference: we should in any case like to see the work of the Task Force given a strongly technical slant, and kept as far as possible out of policy areas.

Background

4. The Development Committee meets at Libreville on 22 May. The Secretary, Mr Kastoft of Denmark, has recently circulated the first draft of an agenda (copy attached). This is due to be discussed by the Board of the IMF and of the IBRD next week. As before, the underlined sections look like proposed drafting for an eventual communique. We will be trying to incorporate certain changes before the agenda is finalised.

5. The main change we will be seeking is in the degree of commitment to the proposed energy affiliate. We will be welcoming the report of the Task Force on ~~Non-~~Concessional Flows which puts forward some imaginative ideas for increasing co-financing.

6. We guess that the Dutch (supported no doubt by the Danes) will press the case for setting up a new Task Force on Concessional Flows. At the end of the day all the major countries including the UK may find it expedient to participate. However the proposal does have dangers, and if the Americans, say, and possibly the Germans decided to stay out along with us, then the proposal might not be proceeded with. At this stage it seems best not to accept or reject British participation but to point to possible dangers on the lines indicated.

7. No chairman has yet been selected. But one name canvassed is Jacob Everts, a Dutchman. He has a great deal of experience in the aid field. The ODA give him good marks for commonsense and co-operativeness. If Everts, a technocrat, were appointed, that should help to keep the exercise at a technical level, and away from policy. We should not commit ourselves to him at this stage, but should strongly oppose any suggestion of appointing a "political" figure.

8. You will be expected to say more about this when you see Mr Ibarra on 10 April.

BRIEF NO3

30/3/81. 17

No. 3

INFORMAL MEETING OF FINANCE MINISTERS : 3-4 APRIL 1981

MACRO-ECONOMIC POLICY AND INTEREST RATES

Objectives

1. To see that interest rate policy is properly discussed in the context of counter-inflation and fiscal policy [if necessary, to counter unrealistic calls for a general reduction in interest rates].

Points to Make

2. i) Agree with Commission (First Quarterly Report) that weaker than expected economic position does not justify an easing of policies to reduce inflation or to push ahead with structural adaptation.

ii) Interest rates regrettably high. Main condition for reducing them are consistent fiscal and monetary policies and sustained reduction in inflation. UK Budget to be seen in this light. Cannot see how it is feasible to organise a general reduction in interest rates while inflation remains excessive in many countries.

iii) Community economies have many problems:

- large EC current account deficits contrast sharply with current surplus in US and elimination of deficit in Japan. So some members feel hemmed in by external constraints.
- continuing high inflation.
- difficulties in ensuring necessary real income adjustment (some indication that Japan and US more flexible in this sense).

iv) These problems reflect many things, eg excessive vulnerability to oil price increases, large public sector deficits, indexation of wages and social benefits. Member countries affected in varying degrees. Policy priorities might be the same for each country. But way in which policies are worked out will inevitably differ.

Background

(a) National views

3. Far from clear what purpose further discussion of macro-economic policy is intended

to serve. Maastricht communique endorsed prudent policies as reaffirmed in Commission's guidelines adopted at March ECOFIN. But several countries, eg Belgium, Netherlands, Italy, Ireland, are uneasy about general restrictiveness of policy and especially the high level of interest rates. They (and others) long to discover a simple way out. In the absence of one there has been a tendency to look for scapegoats. The US has been cast in this role (see separate brief). So, more recently and rather less abrasively, has Germany. The Dutch, Belgians and Italians have all complained about German moves in February to push up short term interest rates.

4. Misleading to believe that rather fashionable notions of concerted action (eg on interest rates) can help much. Divergences between EC economies too great, expecially in terms of inflation performance and degree of external and internal imbalance.

5. Inflation relatively good in Germany, Netherlands and Belgium. Each has very high real interest rates. In Germany's case this has been dictated mainly by DMark weakness; the Netherlands and Belgium have had little alternative but to follow suit.

6. However, Belgium also belongs to a second group of countries in which current account and budget deficits are way above the EC average as percentages of GNP, and which may not in any event have been able to avoid relatively high nominal interests rates. This group also includes Italy, Denmark and Ireland. All are attempting to reduce public sector borrowing against the background of rapidly increasing unemployment. Italy and Belgium introduced emergency budget measures and raised interest rates in March. It is hard to escape the conclusion that both countries were able for a while to hide behind the skirts of DMark weakness. With the DMark again at the top of the EMS they have been forced to act. But the Belgian franc has been dangerously exposed by the devaluation of the Lire.

7. In France and the Netherlands, budget deficits are comparatively small. But French inflation has proved very stubborn, earnings growth has accelerated and interest rates are not felt to be higher than domestic considerations warrant. In the Netherlands, the size of the public sector and very high labour costs (in absolute terms) have created major structural problems. A measure of de-indexation has been pushed through and (elections permitting)further significant public expenditure cuts are planned.

(b) <u>The Outlook</u>

Community GNP grew by 1¼ per cent in 1980. Growth was concentrated in first quarter of the year and subsequent recession, has been sharper and could be more prolonged than once thought likely. The trough of the recession may now be in sight in both the UK and the rest of the EC, but an upturn is unlikely before mid-year at the earliest and even then would be sluggish. Commission expects overall Community GNP to decline by ½ per cent in 1981, with only France, Ireland and Greece enjoying positive growth. But this is much smaller decline than in 1975, when GNP fell by 1¾ per cent. Much of the difference this time round is accounted for by less pronounced stock cycle and more buoyant private investment.

9. Consumer price inflation in the EC peaked last July at about 14 per cent on a year earlier. Since then improvement has been very modest with the rate falling only to 13¼ per cent in December 1980. Towards the end of the year the rate began to accelerate in Germany (because of DMark depreciation) and in France and Italy (at the same time as an upturn in earnings growth).

10. Unemployment in member countries increased by 1.8 million in the year to January 1981 to 8.5 million.

11. Combined EC current deficit was almost $40 billion in 1980 (57 per cent of the OECD total). This year it is expected to be about $30 billion (75 per cent of the total). The German deficit of $15 billion in 1980 is expected to show some reductions later this year, though the authorities think the decline will be very small. France seems likely to show a continued large deficit this year, but Italy and the Netherlands may achieve some improvement.

ANNEX - SUMMARY TABLES

TABLE 1: REAL GNP, Percentage Changes

| | Actual | | Commission forecast |
|---|---|---|---|
| | 1979 | 1980 | 1981 |
| Germany | 4.6 | 2.0 | - 0.7 |
| France | 3.2 | 1.8 | 0.5 |
| UK | 1.3 | - 2.0 | - 2.0 |
| Italy | 5.0 | 3.8 | - 0.8 |
| Netherlands | 2.2 | 0.2 | - 0.6 |
| Belgium | 2.4 | 1.2 | - 0.7 |
| Denmark | 3.5 | - 0.9 | - 0.1 |
| Greece | 3.8 | 1.4 | 2.4 |
| Ireland | 1.9 | 0.8 | 1.8 |
| Luxembourg | 3.6 | 0.4 | - 1.0 |
| EC Average | 3.5 | 1.3 | - 0.6 |

TABLE 2: CONSUMER PRICE INFLATION, Percentage Changes

| | 1979 | 1980 | Lastest month on a year earlier |
|---|---|---|---|
| Germany | 4.1 | 5.5 | 5.5 (Feb) |
| France | 10.7 | 13.6 | 12.8 (Jan) |
| UK | 13.4 | 18.0 | 12.5 (Feb) |
| Italy | 14.8 | 21.2 | 19.5 (Feb) |
| Netherlands | 4.3 | 7.0 | 7.1 (Jan) |
| Belgium | 4.5 | 6.6 | 7.0 (Jan) |
| Denmark | 9.6 | 12.4 | 10.7 (Jan) |
| Greece | 17.7 | 24.5 | n.a. |
| Ireland | 13.7 | 18.2 | n.a. |
| Luxembourg | 4.5 | 6.3 | 7.3 (Jan) |
| EC Average | 9.9 | 13.9 | n.a. |

TABLE 3: CURRENT ACCOUNT BALANCES, Per cent of GNP

| | Actual | | Commission forecast |
|---|---|---|---|
| | 1979 | 1980 | 1981 |
| Germany | - 0.7 | - 1.7 | - 1.6 |
| France | 0.1 | - 1.3 | - 1.8 |
| UK | - 0.9 | 1.0 | 0.3 |
| Italy | 1.6 | - 2.6 | - 1.4 |
| Netherlands | - 1.4 | - 1.5 | - 0.9 |
| Belgium | - 2.9 | - 5.6 | - 6.6 |
| Denmark | - 4.6 | - 4.1 | - 3.7 |
| Greece | - 2.9 | - 2.6 | - 2.9 |
| Ireland | 1.6 | - 2.6 | - 1.4 |
| Luxembourg | 28.7 | 20.8 | 18.0 |
| EC Average | - 0.5 | - 1.5 | - 1.6 |

TABLE 4: UNEMPLOYMENT RATES, Per Cent of civilian labour force

| | 1979 | 1980 | Jan 1981 |
|---|---|---|---|
| Germany | 3.4 | 3.4 | 4.1 |
| France | 6.0 | 6.4 | 7.0 |
| UK | 5.3 | 6.9 | 9.1 |
| Italy | 7.5 | 8.0 | 8.0 |
| Netherlands | 4.1 | 4.8 | 6.1 |
| Belgium | 8.7 | 9.4 | 10.4 |
| Denmark | 5.3 | 6.2 | 8.1 |
| Greece | n.a. | n.a. | n.a. |
| Ireland | 7.9 | 8.8 | 10.5 |
| Luxembourg | 0.7 | 0.7 | 0.9 |
| EC Average | 5.3 | 6.2 | 7.1 |

BRIEF NO4

30/3/81

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No. 4

INFORMAL MEETING OF FINANCE MINISTERS: 3-4 APRIL 1981

RELATIONS BETWEEN COMMUNITY COUNTRIES AND THE US

Objectives

1. To promote a balanced approach to the question of US policies. To oppose any renewed attempt to organise a joint approach to the US on interest rates.

Points to make

2. (i) US policies aimed at reducing inflation. Community cannot object to this. Equally we all have an interest in a strong dollar. World's principal reserve currency must retain its value.

(ii) Would be regrettable if US failure to control fiscal deficit put excessive strain on monetary policy. But the Administration is placing emphasis on fiscal policy. Both the Administration and Congress seem to recognise the importance of keeping tax and expenditure cuts in phase.

(iii) Problems caused by volatility of US interest rates have already been pointed out to US authorities by Central Bank Governors at Basle. Seriously doubt whether it would be prudent to make further approaches at EC level. We are not in a position to dictate to the US on monetary control techniques.

Background

3. Debate on US interest rates has rumbled inconclusively for several months. Germany has played a leading but ambivalent role. Chancellor Schmidt and Finance Minister Matthoeffer (both SPD members) have been publicly critical of the level of US rates, perceiving a conflict between domestic and external policy considerations in Germany. The Germany measures in February to push up short term interest rates were officially (but privately) acknowledged as a move to compete with the US. At the same time, both Bundesbank Chairman Pohl and Economics Minister Lambsdorff (an FDP member) have indicated that high US rate were necessary to combat inflation and Europe would have to live with them. And Bundesbank spokesman have stressed that higher German rates were necessary for domestic as well as external reasons.

4. Schmidt's concern has been widely echoed in other EC countries, especially Belgium and the Netherlands where real interest rates are high. Although earlier calls for a joint approach to the US appear to have lapsed, the issue remains live. The French were anxious that it should be discussed at Maastricht; Sig.Ortoli reportedly still favours some sort of joint approach; and several other countries seem to want to pursue the matter bilaterally with the US.

5. The Maastricht communique stated that:

> "In the field of monetary policy, an intensification of the dialogue with the US is desirable, in particular with a view to achieving a concerted attitude on monetary policy and interest rates.

The Finance Council was requested to act accordingly.

6. It is not clear what action might be envisaged, or indeed what "a concerted attitude" means, if anything. The general preference seems to be to convince the Americans that interest rates should be more stable and that the exchange market impact of policies should be taken into account. Lip-service, at least, is paid to the view that nothing should be done which calls the US anti-inflation strategy into question.

7. The UK does not oppose the idea of asking the US to put as much weight as it can on fiscal policy so as to relieve the burden on monetary policy. Mr Volcker holds the same view and this approach was adopted in the UK Budget. But the UK Administration already has clear fiscal goals which it sees as part of a low interest rate policy. It is aiming for phased and broadly synchronised tax and public spending cuts.

8. As to the volatility of US interest rates, some part of this can be attributed to monetary control techniques. Nevertheless, the Fed has recently reaffirmed its view on the superiority of these techniques over those which rely primarily on interest rates.

9. More specific, technical suggestions on interest rate and exchange rate relations between the EC and the US might emerge from the studies on the workings of the EMS currently being carried out by the Monetary Committee and the Committee of EC Central Bank Governors.

30/3/81.

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No. 5

BRIEF 5

INFORMAL MEETING OF FINANCE MINISTERS : 3-4 APRIL 1981
PREPARATIONS FOR THE JUMBO COUNCIL

Objective

1. Ensure that the Jumbo Council does not take place under our Presidency (1 July - 31 December 1981).

Points to make

2. There is a risk of raising unrealistic public expectations of Community action on unemployment; important to prepare thoroughly.

3. Suggest Commission consult Finance as well as Employment Ministries on any papers they intend to put to the Council.

4. (Defensive) Suggest first step is for Employment Ministers to consider the matter.

Background

5. The proposal for a joint Council of finance and employment ministers to consider the employment position was put forward by the Dutch Prime Minister in December and approved by the European Council. At Maastricht, the Council stressed the need for thorough preparation. It is not clear what the Jumbo Council would be expected to achieve, but it seems unlikely to produce any constructive conclusions and could well become the focus of pressure from the European TUC and others for relaxation of monetary restraint, for work sharing, and for increased public expenditure.

6. Mr Richards' Social Affairs Directorate is preparing a paper on the Community response to unemployment which is likely to be discussed at the informal meeting of Employment Ministers next week and then put to the Social Affairs Council in June; whether this is intended also to form the basis for discussion at the Jumbo Council is not yet clear.

BRIEF No6

25

RESTRICTED

30/3/81.

EXPORT CREDIT CONSENSUS

Line to Take

1. The Consensus is now under increasing strain. In negotiations with other participants, the Community's aim must be to preserve the Consensus as an effective international discipline on financing terms, in order to avoid a destructive credit race.

No. 6

2. On interest rates, it remains important to raise the level of Consensus minimum rates nearer to average market levels. But significant progress on this front may depend on resolution of the problem posed by countries, such as Japan, whose market rates are below those of the Consensus minima and who rely on officially supported finance for exports. In the present state of European-Japanese trade relations, any arrangement which appeared to accord Japan specially favourable treatment would not be acceptable.

3. Proposals for change should cover all aspects of the Consensus, not just the interest rate issue. It is particularly important to achieve greater transparency and tighter discipline on mixed credits. This is an area of increasing concern where more and more countries (including Japan and ourselves) are taking defensive action of one kind or another. Specifically, the introduction of prior notification requirements for mixed credits offers with grant elements in the 15-25% range would represent an important step forward. This should form part of the EC mandate for the meeting of Consensus participants in May.

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## Background

1. Consensus participants failed to reach agreement in Paris last December on the key issue of bringing minimum interest rates more into line with market rates. The EC proposal for an increase in interest rates (1% for rich/intermediate countries and 0.8% for poorer countries) was unacceptable to the Japanese without a loophole allowing their Exim bank to offer credits at below matrix rates, reflecting their lower market interest rates. Participants did however agree to consider the level of minimum interest rates at each annual review of the Arrangement; and a new deadline of October 1981 was set for a solution on the lines agreed at the Venice Summit.

2. Since December the Americans have carried out their threat to derogate from Consensus rules on maximum credit length in selected cases, and a number of countries (including Japan and ourselves) have announced new mixed credit facilities as defensive measures. But, contrary to some recent press reports, there has so far been no general breakdown in discipline under the Consensus.

## Commission Proposals (ATTACHED BELOW)

3. Following a fact-finding trip to Japan, the Commission have now put forward proposals for the EC negotiating mandate at the annual review meeting of Consensus participants in May. These were discussed in the Policy Co-ordination Group on Export Credits on 26 March and are likely to come before the ECOFIN Council on 13 April.

4. The main elements of the Commission's proposals are:-

   i. The same increase in minimum interest rates (ie. 1% - 1% - 0.8%) as was proposed by the Community at the December meeting. This would produce a new matrix of minimum interest rates ranging from 8.3% to 9.75%.

   ii. Use of trends in medium term interest rates of the 5 major trading currencies as a benchmark for the annual review of Consensus rates, with an increase of more than 1% in the average of these rates creating the presumption of an increase in Consensus rates.

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iii. Agreement not to subsidise credit on sales to other Consensus participants from January next year.

iv. Improved notification arrangements for mixed credit offers, involving prior notification of credits with a grant element in the 15-25% range, and prompt notification of those with a grant element greater than 25%.

v. Japan expected to continue to conform to Consensus rates on credits financed through its Exim bank, pending further study of the problem of low interest rate countries.

Minimum Interest Rates

5. Within the Community there is considerable support for a larger increase in interest rates than that suggested by the Commission (increases as high as 2-2½% have been mentioned by some countries). But, since it was the Japanese problem which prevented agreement on an increase in December, it is unrealistic to envisage significant increases in Consensus rates being achieved until an acceptable solution to this issue has been found. In these circumstances, while we have no objection to proposals for larger interest rate increases (and we believe the Commission would be content to propose an increase of up to 1.5% if this were agreed by member states), it seems sensible for the EC to have a flexible mandate on interest rates in May, so as not to rule out the possibility of securing some immediate rise in rates, however small. The French and the Greeks are likely to oppose a larger increase in rates than that already proposed by the Commission. We would prefer to see a flat rate increase (ie. not differentiated by category of borrower). The matrix of Consensus rates already involves preferential rates for poor countries, and to widen this differentiation would further blur the distinction between aid and commercial credit.

"The Japanese Problem"

6. The Germans have pressed for a flexible approach on the problem of low interest rate countries (until recently they have been in this category themselves; and they support an eventual solution under

which Consensus minimum rates would be differentiated by currency). Other EC members, including ourselves, are more cautious, pending further analysis of the Japanese situation and the position of the new US administration. The Japanese capital market is closely regulated, and it is clear that the system of financing through Exim bank could be used to keep Japanese export credit interest rates artificially low. We would accept the Commission's view that it is premature to offer concessions to the Japanese at the May meeting: the main objective then must be to test the strength of the Japanese position and hold the Consensus together, pending further study of possible ways of dealing with the low interest rate problem, which will need to cover the availability of yen financing and the possibility of matching Japanese offers. This may mean that no increase in interest rates can be agreed in May, and that the Community will have to adopt a more flexible approach in order to reach agreement before the deadline of October 1981 which was set last December.

Mixed Credits

7. Of the other elements in the Commission's proposals, the most important is the improved notification of mixed credit offers. This change is strongly supported by nearly all Consensus participants, and would have been included in the December mandate but for French opposition. Its inclusion now would help to improve the negotiating climate in May. French officials have been put under strong pressure on this point in official-level discussions within the Community and we believe that French Ministers may now be prepared to agree to this proposal if they are pressed by their colleagues to do so.

Other Proposals

8. The Commission's other two proposals (paragraph 4ii. and iii. above) are not likely to gain acceptance by member states at present. That on using movements in interest rates of the major trading currencies as a benchmark for the annual review of Consensus rates is in principle acceptable to us, but has already been rejected by the French (who are adamantly opposed to any semblance of automaticity). There is general agreement among member states that it would be premature to include the Commission's idea of a ban on official support for credits between Consensus participants in the negotiating mandate for the May meeting. Our position on this is

that in principle we are attracted by any proposal which offers the prospect of a reduction in the subsidy bill; we are certainly prepared to study further the Commission's idea within the Community; but a good deal more work on the detailed implications is necessary before a firm proposal on these lines could be put forward.

AEF3 Divison
1 April 1981

BRIEF NO 7

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30/3/81.

BUDGET RESTRUCTURING : SPEAKING NOTE FOR INFORMAL CONTACTS

1. Essential that this time we get it right. Community can't go on having huge arguments year after year, and just patching them up. So very important that we all encourage the Commission to make their June report a thorough and serious review of the options.

2. Of course there are many aspects to the problem. As one contribution, the UK has been urging the case for some limit to be placed on agricultural spending. That would help both with restructuring and with CAP reform. Others will have other ideas. But changes in the mix of policies are unlikely, in themselves, to be sufficient.

No. 7

3. The Community will therefore have to decide more consciously what should be the pattern of net contributions and receipts for member states. That is the only way to be sure that "unacceptable situations" will be a thing of the past. Up to now, the pattern has resulted haphazardly from decisions taken by different councils for different purposes. Especially with enlargement coming up, that will not do. The strain on contributor countries like Germany and the UK could be too great and too unpredictable.

4. The pattern of net contributions and receipts must clearly be defensible, so it should be related to things like relative prosperity and population. But there is no "British formula".

5. Nor is there a "British scheme" for bringing about the desired result. No doubt there are a number of alternatives. They need not call into question the own resources system.

6. The important thing now is that we should commit ourselves to face the problem squarely when the Commission has reported.

BRIEF NO 8

32

30/3/81.

No. 8

## Draft Non-Life Insurance Services Directive

**Objective:** To show that we are sustaining the political push for a directive which we and the Dutch began at the Finance Council on March 16.

**Points to make:**

(1) The directive has been under discussion for five years and many meetings. An agreement is long overdue.

(2) Progress towards freedom of services has been slower than in other areas.

(3) The technical aspects are well, understood and not difficult to resolve with impetus from the political level.

(4) With Herr Matthoefer: we share your interest in free trade. The barriers to cross-border insurance reduce efficiency in Germany as well as elsewhere and are not compatible with the objectives of the Treaty.

(5) With M. Monory: we much admire your efforts to liberalise financial markets in France. There is an opportunity to give this national endeavour (which we share) a Community dimension.

**Essential facts**

(1) The Finance Council on 16 March agreed that COREPER should study points of difficulty with a view to further discussion possibly at the Econ/Fin Council in May.

(2) Earlier directives have already substantially harmonised prudential requirements in insurance. The draft would further tighten these. There is a sound basis for liberalising insurance services.

(3) Authorisation is the key. We think authorisation by one member state should count for all.

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4. Freedom of services is a right under the Treaty. It has been confirmed by judgements of the European Court.

30/3/81.

BRIEF NO9

34

BRIEF ON SALARIES OF COMMUNITY STAFF

OBJECTIVE

To seek to persuade Finance Ministers to influence in the direction of firmness their Foreign Affairs colleagues who will shortly be considering recent Commission proposals

POINTS TO MAKE

(a) There is considerable evidence that salaries of Community staff are too high; one proof of this is the queue of potential recruits for vacant posts.

(b) There must therefore be some room for cutting back, and this is important given that staff remuneration etc. takes up a not insignificant part of the Community Budget.

(c) The level of pay in one international organisation may reflect on levels in others, and indeed may have an influence on levels of pay in host countries.

No. 9

(d) Domestically, Governments are all having to take difficult decisions on the pay of public servants in the context of seeking to control public expenditure and to contain inflation. All member governments have also found it necessary to adopt a general approach to the Community Budget consistent with their domestic approach; it is therefore equally important that the approach to Community pay should be seen to be consistent with that adopted in relation to domestic decisions.

(e) It is very important that the Council should take a very firm line in the review of the pay methods of the Community. The Council must be united in this if it is to overcome both the expectations of the staff for a continuation of the present over-generous system and the attitudes of the Commission. It would assist in this if we, Finance Ministers, made our views clear to our colleagues who will be considering the latest Commission proposals and will be involved in further discussions with staff representatives.

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BACKGROUND

A note, based on material supplied by the Civil Service Department, is attached. It describes the present arrangements for determining Community staff salaries, why they are open to considerable criticism and the position now reached following indistrial action by the staff.

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EUROPEAN COMMUNITY STAFF - METHOD OF REVIEWING SALARIES

BACKGROUND NOTE

## Basic Principles

Since 1976 the Council has had a policy designed to ensure that, in the medium term, remuneration paid to European officials moves parallel to average salaries paid in the Member States to the various grades of national civil servants.

2. The Staff Regulations (Article 65) provide for an annual review of salaries by the Council based on a report by the Commission supported by statistical information prepared by the Statistical Office of the European Communities in agreement with the national statistical offices of the Member States. The Council is required to consider whether, as part of the economic and social policy of the Communities, remuneration shall be adjusted. The Regulations state that particular account is to be taken of any increases in salaries in the public service of Member States and the needs of recruitment.

3. The Regulations also provide for a review at any appropriate time of the rates paid locally to Community staff based in given countries if there is a substantial change in the cost of living.

## Current Practice

4. The annual review takes place towards the end of each year but is based on, and has effect from, 1 July of that year. The practice has also been developed of mounting a single interim review looking at cost of living only (paragraph 3 above) in the middle of each year looking back to 1 January. (Recently the Commission has also started to make a number of special proposals for quarterly adjustments for those countries with exceptionally high inflation.) Cost of living adjustments are applied by a system of weightings to basic scales in Belgian francs.

5. Factors considered in Annual Review. The annual review is supposed to take account of:

a. purchasing power: statistical evidence of the movements

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in real income of civil servants in the Member States.

b. cost of living: statistical evidence of local variations in countries in which Community staff work.

c. general economic and social factors: macro-economic information designed to indicate policies of Member States.

d. recruitment needs: a comprehensive survey of facts and future prospects.

In practice the Commission has relied upon evidence on only a. and b. to achieve the desired aims of parallel developments with Member States and equality of purchasing power between different locations. Its annual report has not included data on recruitment and although certain figures have been supplied on economic trends they have not been used in any systematic way.

6. The Interim Review. An annual inflation rate of 4% was sufficient to trigger off local adjustments (in full) upto 1980, when 7% (ie 3.5% in the first 6 months) was applied. Insofar as any threshold has been developed for more frequent (quarterly) adjustments, this has appeared at a very much higher (ie 40% to 50%) level.

Basic Criticisms of the Method

7. Several Member States (including the UK) have felt that the starting point for "parallel developments" was quite simply too high and that under the current method Community officials may move still further ahead of the best paid national civil servants as time goes by. (If a large but relatively poorly paid Member State starts to "catch up", it pushes the weighted average up over which the Community then maintains its lead). Differences in allowances and tax provide scope for confused argument over the extent of the lead but there is one fairly reliable method of comparing basic salaries and that is to take a national civil servant working in his own country and compare his net salary with the net salary he would receive if he worked at roughly the same level for the local office of the European Communities. In the UK this shows that civil servants, and middle ranking Community officials get paid as much as top British civil servants. For top Community officials one moves into the realms of comparisons

with Board Chairmen of major corporations. It must be seriously open to question whether these hugh advantages are necessary to persuade people of adequate quality to work for the offices of the Community in their own countries.

8. Other basic criticisms relate to the granting of interim cost of living increases; the lack of controls over grade drift; the procedures for compiling local cost of living indices; and (not covered by the review of the Method) the level of allowances paid to expatriates on top of their basic salaries.

Recent Developments

9. The staff took indistrial action in January and February 1981 over what they saw as an arbitrary Council decision in January not to pay the full annual salary increase recommended by the Commission. They were also alarmed at a Council statement announcing a new policy of "harmonisation" of EC salaries with those of officials of Member States. Industrial action was however called off after the February Council meeting at which the Commission undertook to make a fresh proposal on the method of determining salaries and the Secretary General agreed to look into the possibility of having an improved system of consultation with the staff.

10. Regrettably, the Foreign Affairs Council allowed itself to be rushed into using a new consultation procedure on a trial basis as from 18 March until their meeting of 18 May when the procedure will come up for ratification or amendment. This will stack the cards in favour of the staff when the Commission's new pay proposals are considered at the same meeting.

11. The Commission's proposals have just been received and are receiving initial working party scrutiny as from 30 March. The formal proposal is for an even more rigid relationship between EC staff and Member States to preserve their advantage, but there is a separate suggestion of an "exceptional one off sacrifice" under which the staff would accept some relative reductions over a period of 5 years. No figures have been suggested.

30/3/81

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BRIEF 10

INFORMAL MEETING OF FINANCE MINISTERS : 3-4 APRIL 1981

AID TO TURKEY

Line to Take /defensive/

1. (If asked) UK likely to pledge similar amount to last year /ie. about £15 million/.

2. (If pressed) Whilst we welcome the encouraging progress made by the military government in getting to grips with the country's economic problems, the case for aid on purely developmental grounds remains weak. Nonetheless we recognise the overriding political importance of helping Turkey /NATO's southern flank etc/.

3. (If pressed) Given the difficult economic situation, overseas aid cannot be immune from the pressures affecting other forms of public expenditure. We cannot do more /In cash terms/ than last year and even that is difficult.

No. 10

Background

4. There will be an OECD pledging session later this month or early next. Our pledge has not yet been decided, but is likely to be a £15 million soft loan - the same in cash terms as last year.

30/3/81.
BRIEF No. 11
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CONFIDENTIAL

PRINCIPAL PRIVATE SECRETARY

Sir K Couzens
Mr Barratt
Mr Hancock
Mrs Hedley-Miller
Mr Lavelle
Mr Fitchew
Mr Gray
Mr Scholes
Miss Wright (for UKREP)

INFORMAL MEETING OF FINANCE MINISTERS: 3-4 APRIL - BRIEF ON POSSIBLE FURTHER EMS REALIGNMENTS

Sir K Couzens suggested that the Chancellor should have among his papers for this meeting a note against the possibility that a further EMS realignment could be proposed during the course of the two days.

2. Although the Belgians are showing considerable determination not to devalue, the Belgian franc remains under considerable pressure - and the central bank has had to intervene again today on a substantial scale. While a change in parity for the Belgian franc remains the most likely trigger for a further realignment, it is possible that were it to occur other realignments could be proposed at the same time. Even with no realignment, current pressures on the Belgian franc could make the subject a topical one.

No. 11

3. The background note to the attached brief, prepared with considerable help from IA, discusses possible implications for us of various kinds of realignment. The conclusion is that we have no strong interest in any particular outcome, and could go along with any proposed realignment on which the others were prepared to agree.

DLCP

D L C PERETZ
2 April 1981

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INFORMAL MEETING OF FINANCE MINISTERS: 3-4 APRIL 1981

POSSIBLE FURTHER EMS REALIGNMENTS

Objective

(if subject comes up). To take a back seat in discussion, to welcome any sensible realignments - including, if proposed, a more general realignment involving increases in the DM and guilder parities as well as devaluations of the Belgian franc (and possibly the Irish Punt).

Background

With the DM back at the top of the EMS band and the lira devalued, the Belgian franc has looked very exposed at the bottom - with its position undermined further by the Government crisis over the last few days. The Belgians seem determined not to devalue, and the central bank has been intervening on a large scale for some weeks. But substantial support has continued to be needed even after this week's 4% increase in bank rate, and in the end the current parity may prove unsustainable. It is certainly possible, therefore that a further EMS realigment could be proposed in the course of the meeting. Even if it is not the general subject of EMS parities could become a topic of conversation.

As a non-member of the EMS margin arrangements the UK would be expected to take a back seat. But we are members of the system (including the EMCF) and have a right to participate in the re-alignment decisions; and sterling is in the ecu.

Apart from the Belgian franc the Punt is beginning to look a little exposed to devaluation (on 1 April 2% below the DM); and there could be suggestions that the DM and Guilder should be adjusted upwards. The rise in the DM against the $ since mid February has exposed strains in the system that had been previously hidden by the DM's weakness, so a rise in the DM parity might be seen as logical.

So far as we are concerned there seems little to choose between the various possible options. Were a realignment proposed we could probably accept the outcome on which the others were prepared to agree.

The value of the £ against different EMS currencies after any realignment would be settled in the market. Although individual cross-rates would change, it seems most unlikely that the effective sterling exchange rate or trade-weighted rate against EMS currencies would in the end be affected one way or another. In that case there would be no overall gain or loss to UK exporters, though the balance between different EC markets would change.

The £/ecu rate would also be affected, and their could be agri-monetary consequences. The attached Annex prepared by IA examines the consequences on three possible realignments. With the current CAP price negotiations concluded, and new green rates likely to be agreed on 2 April, any implications would be for the future. Any of the possible realignments could provide future scope for green rate devaluations by Belgium, and by Ireland as well, if the Punt were devalued. If the DM and Guilder were revalued there would be scope for a small increase in their green rates. Any implications for other member states (including the UK) would seem likely to be at most marginal.

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ANNEX

## AGRI-MONETARY EFFECTS OF POSSIBLE EMS REALIGNMENT

1. Following the CAP price fixing settlement, new green currency rates and MCAs will be fixed to come into operation from 6 April. It is expected that the new position will be:

| | Agreed Green Currency Change | New Raw Monetary Gap* | New MCA |
|---|---|---|---|
| UK | 0 | + 14.4 | + 12.9 |
| Belgium - milk | - 0.2 | 0 | 0 |
| - other | - 0.7 | 0 | 0 |
| France | - 2.5 | 0 | 0 |
| Italy | - 6.0 | - 2.5 | - 1.0 |
| Netherlands - milk | - 0.2 | 0 | 0 |
| - other | - 0.7 | 0 | 0 |
| Germany - milk | + 4.5 | + 4.2 | + 3.2 |
| - other | + 3.5 | + 4.2 | + 3.2 |
| Denmark | - 2.5 | 0 | 0 |
| Ireland | - 3.8 | 0 | 0 |
| Greece | - 2.9 | 0 | 0 |

* Raw monetary gap is the absolute difference between green rates and current market rates for UK, Italy and Greence; and between green rates and central rates for other countries. MCAs differ from the raw monetary gap because of the deduction of franchises.

2. Green rate devaluations will be made by Benelux, France, Denmark, Ireland and Greece to bring green rates into line with central/market rates. The Italian green rate will be devalued by 6% but still leaving a small negative MCA of 1%. Germany will be revaluing by their green rate, but the UK will not; both countries will still have positive MCAs.

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## Implications of a further EMS realignment

3. The following section illustrates the implications of three possibilities:-

(a) Belgium devaluing by 5%

(b) Belgium and Ireland devaluing by 5%

(c) Germany and the Netherlands revaluing by 2% and Belgium and Ireland devaluing by 3%.

In all cases it is assumed for simplicity there is no new change in the imputed rate for sterling.

4. The different examples would have varying affects on the weighted value of the ECU vis-a-vis third currencies:

Case (c) would be a weighted depreciation of 0.47%

Case (b) would be a weighted depreciation of 0.52%

Case (c) would be a weighted appreciation of 0.54%.

5. It is these weighted affects on the ECU which largely determine the agri-monetary effects. When the ECU weakens member currencies have appreciated against it, implying a widening of the gap between green rates and central/market rates where green rates were below central/market rates, ie a reduction in negative MCAs and an increase in positive MCAs. Conversely a strengthening of the ECU means an increase in negative MCAs and a reduction in positive MCAs - ie the position following the last realignment when the ECU strengthened by some 2½%.

6. But the size of the changes implied by the above examples is much smaller - of the order of ½%. Because of various rules whereby MCAs are changed only in response to exchange rate variations

of more than 1% there would be only limited immediate MCA changes particularly for countries not directly involved in the realignment:

(a) In this case:

(i) Belgium would acquire a negative MCA of around 4% (5% less a 1% franchise) giving scope for a green rate devaluation.

(ii) No other country would change its position. (Although for those countries where MCAs are determined in relation to market rather than central rates - UK, Italy and Greece - it would bring closer an increase in positive MCAs/reduction in negative MCAs if market exchange rates were strengthening).

(b) In this case the effects would be the same as under (a) except that Ireland as well as Belgium would acquire a negative MCA of some 4%.

(c) In this case:

(i) Belgium and Ireland would have negative MCAs of some 2% (3% less a 1% franchise).

(ii) Germany would increase its positive MCA by some 2% and the Netherlands acquire a positive MCA of 1% (2% less a 1% franchise).

CONFIDENTIAL

BRIEF 12

30/3/81.

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INFORMAL MEETING OF FINANCE MINISTERS : 3-4 APRIL

FUTURE INFORMAL MEETINGS

Objective

1. To find out if your colleagues want a further informal meeting during the UK Presidency.

Line to take

2. UK welcomes these meetings, but wonders whether we need a second meeting this year.

3. Impossible to arrange such a meeting until after the IMF meetings in Washington (29-30 September).

4. Only question is whether colleagues would find it useful to have a totally informal discussion of budget restructuring. What are your views?

5. [If mood in favour of such a meeting] Agree

6. [If colleagues neutral or against such a meeting] Look forward to next meeting in Belgium.

No.12

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ES 116/117/03

MR SPRINGTHORPE

cc PS/Chancellor
Mr Cardona

Contributors:

Mr Allen EB
Mr Williams EB
Mr Pickering FP1
Mr Lennon HF3
Mr Thornton PE1
Mr Donnelly PE3
Mr Scholes IG2
Mr Thomson IG2
Mr Atkinson IG3
Mr Powell MP1
Mr Haache MP2
Mr Owen EF1
Mr Reed IA1
Mr Mortimer IP1
Mr Andren IP1
Mr P Rayner IP2
Mr Ramell IP2
Mr White SS1
Mr Willetts GEP1
Mr Walters GEP2
Mr Carter GEA1

ESCS for file

BACKGROUND ECONOMIC BRIEF FOR PRIME MINISTER'S QUESTION TIME

I attach the usual weekly brief for the Prime Minister on Government economic policy and recent economic developments. Changes since the 23 March version are side-lined.

2. These notes are also being circulated, as usual, to Messrs Nield and Newby, in the Revenue Departments, to colleagues in IDT, and to briefing divisions in DoI, Department of Employment, Department of Energy, DES, CSO, DOE, Scottish Office, Welsh Office and FCO.

NO.16

M M Deyes

M M DEYES

R.I.A

R I G ALLEN
30 March 1981

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ECONOMIC BRIEF: CONTENTS

## A GENERAL ECONOMIC STRATEGY

### 1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation and promotion of enterprise and initiative. Reduction of inflation requires strict adherence to firm monetary and fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy.

### 2. Why inflation must be reduced

Inflation retards growth by increasing uncertainty, reducing confidence, and discouraging investment and consumption. It tends to hit the weakest groups in society hardest. Success in fight against inflation key to recovery.

### 3. Contribution of 10 March Budget

Essential further step towards achievement of Government's medium term objectives of bringing down inflation and creating the conditions for sustainable growth of output and employment. In order to permit its monetary objectives to be met at tolerable interest rates, Government intends to contain 1981-82 PSBR well below 1980-81 level. The Budget judgement involved higher overall taxation but the Budget also seeks to redress the imbalance between the industrial sector and the rest of the private sector and provide wider opportunities for enterprise, particularly new and small businesses.

### 4. Budget is "deflationary"? "contractionary"? it ignores CBI and TUC recommendations for expansion? it takes £6 billion out of economy?

[CBI wanted Government action costing £1½ billion a year over 4 years; TUC wanted £6¼ billion fiscal boost in 1981-82. Budget involved direct increase in revenue of £3.6 billion in 1981-82 and direct PSBR effect of £3.3 billion; on a revalorised basis these figures are £4.3 billion and £4.0 billion respectively. National Insurance contribution increases announced earlier will involve around £1 billion in 1981-82.]

Wrong to consider Budget in isolation from other policies, including expenditure response to recession. Last year we made plans which allowed for £7½ billion PSBR in 1981-82. This year we have increased that figure to £10½ billion. But the additional £3 billion reflects the impact of the recession on spending and receipts. Thus nothing deflationary about that decision.

### 5. Outside commentators' views on economic effects of Budget

[See B4 for CBI and P & D assessment of impact.]

Wrong to look at Budget measures in isolation. But to extent that do, taking direct effects alone, the short-run effects on output and employment are probably fairly small.

6. Government should have reduced taxes/increased public spending to give a boost?

Budget measures must be seen in context of the medium term financial strategy. Alternative to Budget not reflation but more inflation. More public spending has to be paid for. Alternative to more taxation is "printing money" - the most inflationary path of all.

7. Government should be putting in hand major programmes of public investment? which would benefit the private sector? Should be taken out of PSBR?

[A Harris article in FT 27 March.]

Immaterial whether the money is for capital or current purposes; it still has to be financed. Which means more taxation, more borrowing and higher interest rates or both.

[See also R2-3.]

8. Budget will increase unemployment? why put more people out of work in a recession?

Aim of Budget is to create conditions for growth of output and employment. Recovery from recession now in prospect. Forecasts published with the Budget show output - both in manufacturing and in other sectors - beginning to rise during this year. This will help limit rise in unemployment which is already showing signs of easing off.

9. Budget will be used as excuse for higher pay claims?

Proper criteria for pay claims are the ability of employers to pay; if wages rise faster than productivity, competitiveness will be weakened and result will be further - yet avoidable - unemployment.

10. Budget does too little for industry?

Despite the tight constraints, direct help given to industry in the Budget has been considerable and underestimated. In addition to the 2 percentage points reduction in MLR (worth around £700 million off companies' annual interest charges on bank borrowing) Budget gave a major concession on stock relief (costing some £450 million in full year) and help worth £120 million to help keep down industrial gas and electricity prices. In addition, a wide range of further incentives being given to setting up of new businesses; for example, the Government-backed loan guarantee scheme and the Business Start-up Scheme, which will encourage individuals to invest in new companies.

11. Government making a fetish of PSBR?

Not so. Reduction in PSBR essential if the progressive reduction in money supply we need to curb inflation is to be achieved with tolerable interest rates. With policies unchanged, we would have needed to borrow £14 billion this year. Without this Budget the downward movement in market rates which occurred in anticipation of firm measures would have been reversed. This would have been damaging to economic activity in general, and financial position of companies in particular.

12. Government's problems arise from failure to control public spending?

We remain committed to restraining public spending. We have improved our techniques and my rhF mentioned in Budget speech further reforms he has in mind. Increases in spending above our original plans have stemmed partly from pressures of recession. Nevertheless White Paper plans for 1981-82 are still almost 5 per cent below level planned by predecessors.

13. Government policies shot down by 364 economists?

[Signed statement delivered to PM 30.3.81.]

Lack of professional consensus on inflation and employment. This is nothing new. Compare TCSC report on Monetary Policy, which drew on a wide range of academic evidence, and gave support for general thrust of Government policy, though criticising specific elements. Initiative of the 364 does more, as Mr S Brittan comments (FT 30 March), to discredit the economic profession than the Government. Statement itself is extremely brief and couched in vague generalities - saying "there are alternative policies" but not identifying any. Singularly ill-timed, given the growing evidence that Government policies are reducing inflation and recession may be bottoming out.

14. Government policies destroying industrial base?

Not true industrial base being demolished. Some encouraging developments. Difficulties reflect essential restructuring of industry and world recession. Our policies to bring down inflation essential to achieve sustained growth.

15. Timescale for recovery

Recent indicators suggest we may be close to the bottom of the present recession; FSBR shows some growth in output between first and second half 1981.

16. Imbalance personal and company sector

Consumers have benefited from the higher value of the pound sterling reducing cost of imports into UK, and from British manufacturers paring their prices, so people who have kept their jobs have generally enjoyed rising living standards while the ability of business to sustain investment, employment and output has been eroded. Real personal disposable income has risen by one-sixth in last three years; real disposable income of industrial and commercial companies fell by one-quarter over same period. Budget aims to redress this imbalance.

17. Pay, inflation and unemployment

Success on inflation becoming increasingly apparent. Could perhaps reach single figures this year. Fundamental cause of inflation is excessive monetary growth, without which increases in costs cannot in the long run be reflected in higher general level of prices. When - as now - profit margins are squeezed, excessive pay settlements can only create more unemployment.

18. The supply side

[Steps taken to create climate for enterprise and initiative: cut in income tax; fiscal and other measures to help small and new firms; exchange, dividend, price controls removed, new competition legislation; public monopolies being opened to market pressures; Employment Act helping redress balance in labour market; Government considering ways of improving system of industrial training.]

Companies are tackling problems ignored for far too long. Unreasonable to expect problems to be solved overnight. However, many signs of enterprise are asserting themselves. New businesses being established.

19. Priorities in harmony with those of other countries

Most industrial countries see beating inflation as the top priority (cf Venice Summit, IMF meetings, OECD Survey etc). So far, monetary policy has taken much of the burden in fighting inflation. But most countries now bringing fiscal policy into better balance (public expenditure cuts, lower budget deficits) to make room for lower interest rates and renewed private sector growth.

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## B. ECONOMIC ACTIVITY AND PROSPECTS

[Latest information:

GDP is estimated to have fallen about 1 per cent in fourth quarter 1980; down around 3 per cent between 1979 and 1980 as a whole. Industrial production in three months to January down 2 per cent on previous three months; manufacturing output down 3½ per cent. Consumers' expenditure in fourth quarter 1980 rose 1½ per cent; up ½ per cent 1980 on 1979 as a whole. Retail sales in three months to January 1981 rose 1 per cent compared with previous three months. Export volume (excluding erratics) rose 1 per cent in three months to February 1981. Import volume (excluding erratics) fell 1½ per cent over the same period. Current account showed £614 million surplus in February. Manufacturers' capital expenditure fell 9 per cent in second half 1980; and 9 per cent between 1979 and 1980 as a whole. Capital expenditure by distributive and service industries (excluding shipping) rose about 3½ per cent in second half 1980; between 1979 and 1980 as a whole rose 5½ per cent. Stocks fell sharply in fourth quarter 1980; fall of over £2 billion in 1980 as a whole. December Department of Industry investment intentions survey suggests further falls in investment in 1981 with little change between 1981 and 1982. Latest CBI (March) industrial trends survey confirms turnround that emerged last year in CBI's indicators. Suggests further fall in orders but at a lower rate, continuing low net balance of firms expecting further falls in output, and low net balance (18 per cent) expecting to increase prices in next four months].

### 1. Latest output and production information

Developments broadly in line with expectations. Continuation of output fall reflects the impact of world recession and past failures to adjust. Worst of output fall may now be over. [See Question 2]

### 2. Signs that trough of recession being reached?

CBI's latest monthly Inquiry confirms an improvement in prospects. Together with other indicators such as FT Survey, CSO leading indicators, increased housing starts, labour market indicators and outside forecasts, it suggests we may now be close to bottom of recession. All consistent with Treasury's forecasts published with Budget.

### 3. Treasury forecasts show another gloomy year ahead?

[Treasury forecasts published in FSBR show: 1981 GDP 2 per cent below 1980 but rising between 1st and 2nd half of 1981, exports down 5½ per cent, manufacturing output down 6 per cent, current account surplus of £3 billion; PSBR 1981-82 £10½ billion (4¼ per cent of GDP); year on year RPI inflation 10 per cent in Q4 1981, 8 per cent in Q2 1982]

Treasury's assessment corroborates signs that trough of recession may soon be reached. Prospect is for beginnings of recovery later this year, with single figure inflation around the turn of the year.

4. Outside forecasters see Budget as deflationary?

[Only Phillips & Drew, and CBI, of major outside forecasters, have so far made post Budget forecast. Phillips & Drew see GDP 1½ per cent below what it would have been in 1981, with unemployment 150-200,000 higher by end 1981, but continue to see some recovery in 1981. CBI now see no recovery until 1982.]

Most major independent forecasting organisations have yet to make a post-Budget forecast; it would be premature at this stage to give an opinion on the consensus of outside views.

[See also A5]

5. MTFS ½ per cent per annum growth 1980-83 an indictment of Government policies?

[MTFS in 1980 FSBR assumed 1 per cent per annum growth 1980-83]

Lower average GDP growth than assumed last year reflects deeper than expected recession this year. Taken with forecast in this year's FSBR implies 2¼ per cent growth (at annual rate) between 1982 first half and 1983 second half.

6. Outside forecasts generally for 1981

[As yet only Phillips & Drew and CBI have published post-Budget forecast. Fall in GDP expected in range 1¼ per cent (LBS, NIESR) to 3½ per cent (CEPG, Phillips & Drew, ITEM). Consensus that year-on-year inflation rate in Q4 1981 will be around 10 per cent. All forecast current account surplus (except CEPG) ranging from £1 billion (Cambridge Econometrics) to £5 billion (NIESR). Unemployment is generally expected to exceed 2¾ million by end-year]

All forecasters agree in expecting inflation to go on falling and some foresee single figure inflation before end of year. Some forecasters, in line with Treasury forecast in FSBR, see the fall in output ending soon. Some also see prospect of recovery in latter part of this year.

C LABOUR MARKET

[Latest information: registered unemployed (UK seasonally adjusted, excluding school leavers) rose in March to 2,381,000 (9.6 per cent). This is a rise of 1,120,000 since September 1979 (the previous low point), and is a post-war record. (Highest ever recorded figure was 2,979,400 in January 1933 - but basis for that count not the same as that used today). Notified unfilled vacancies (seasonally adjusted) numbered 97,000 in March and remain very depressed. Manufacturing employment (GB) fell by 720,000 in the year to January 1981. Total employment estimated to have fallen over 1,000,000 in the year to December 1980].

1. Unemployment will continue rising?

Unemployment forecasts very uncertain. Most outside forecasters see rise continuing. But LBS see some decline in 1982. Depends on developments, encouraged by lower settlements that protect competitiveness. Employment will benefit from bottoming out of recession. Tentative indications (lower increase in numbers unemployed, flow on to register down, smaller fall in manufacturing employment over recent months, vacancies bottoming out) that rate of increase in unemployment is moderating - but always tends to lag behind changes in output.

2. Treasury forecasts of unemployment?

[Public Expenditure White Paper published Budget Day used working assumption of an average level of 2.5 million unemployed in Great Britain (excluding school leavers) in 1981-82 and 2.7 million in 1982-83. Sunday Times 21 March claims internal Treasury forecasts of 3.7 million in 1983].

Government does not publish forecasts of unemployment. No change from the practice of previous Government. Forecasts of unemployment would inevitably be very uncertain even for the first year of the forecast, let alone further ahead.

3. 'Natural rate of unemployment' is 5 per cent?

[HMT gave evidence on 25 March that current model equations used without adjustment suggest that at 5 per cent (1¼ million) unemployment, inflation might be expected to be stable. NB HMT avoided giving it as Government view that 'natural rate' was a valid concept - or that it was 5 per cent.]

Level of unemployment depends on competitiveness and efficiency of economy. Nonsense to suggest unemployment can never come down below 1¼ million. Government policies to reduce inflation and improve competition will improve the economy's efficiency.

4. 'Natural rate' is monetarist nonsense?

TCSC raised the question. Well aware of limitations of this theoretical concept.

5. Effect of Budget on employment?

[Phillips and Drew estimate that Budget will increase total unemployment by 150-200,000 by end-1981]

Budget contributes to Government strategy of fostering conditions for sustainable growth. Bottoming out of recession will benefit employment.

6. Prime Minister's attitude to rising unemployment?

I am as concerned as anyone about the waste and heartache involved. But our policies should ensure an ultimate improvement in the ability of UK economy to create jobs. The quicker that pay settlements can be moderated, the lower the transitional cost of the fight against inflation in terms of bankruptcies, lost production and reduced employment, and the sooner recovery can commence. Recent encouraging evidence of pay settlements moderating in the current wages round. Had this occurred earlier, many of our problems would not now be so acute.

7. Government has caused the increase in unemployment? Is using it to hold down wages?

No; fundamental causes are past failure of UK to adapt to changing conditions and opportunities, and increases in earnings unmatched by productivity. Biggest threat to employment comes from excessive wage awards. But encouraging signs that pay negotiators are at last acting more realistically.

8. True level of unemployment is far higher than official figures?

[MSC put labour market paper to NEDO which included discussion of 'hidden unemployment'. TUC 'Plan for Growth' quoted 3.8 million as true level. Phillips and Drew have suggested ¼-½ million unemployed in excess of offical figures. P Riddell FT 26 February referred to ½ million missing workers, P Kellner N. Statesman 27 March to 1 million. Economist 28 March has 720,000 hidden unemployment excluding discouraged workers. Estimates derived from decrease in working population, reduced participation rates, widespread short-time working].

[If TUC paper referred to: TUC adept at criticising official statistics when it suits them.] Unemployment statistics are published on the same basis as under previous administration. We are concerned about unemployment however defined. But our policies are laying foundation for creation of secure employment.

9. Unemployment has increased more under present Government than under previous?

Unemployment has been on rising trend for some time. Regrettably, the increase has accelerated since 1970. [IF PRESSED: percentage increase in unemployment less than under Labour Government. But nothing to be gained from bandying these sad figures around].

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10. Unemployment risen less in other countries?

Whole world affected by rising unemployment. In our case we have additional self-inflicted wounds of high pay awards and low productivity.

11. What is the cost to the Exchequer of the unemployed?

Difficult to calculate; depends on reasons for unemployment and circumstances of those unemployed. February Economic Progress Report (published 11 February) contains estimate by HM Treasury that, for 1980-81, an additional 100,000 unemployment in the private sector costs the Exchequer £340 million. [IF PRESSED on cost of existing unemployed: cannot be naively grossed up. This would render inappropriate assumptions adopted in EPR estimate.]

12. Why not spend public money on new jobs rather than unemployment benefits?

Illusion to think Government can switch employment off and on like a tap at will. Difficult to offer wages much, if anything, above SB/UB levels to employ currently unemployed people in public sector jobs without incurring significant net costs to the exchequer. Unlikely to attract people to take work, and likely to meet fierce union opposition. If wages more generous, there would be a net cost to Exchequer and a disincentive for people to take jobs in market sector and to moderation in wage settlements. Government in any case doing much to help most disadvantaged - young people especially.

13. What is Government doing to provide more jobs?

Government is pursuing firm fiscal and monetary policies to curb inflation and is creating the conditions for regeneration of the supply side of the British economy. These are the only measures that will ensure a sustainable increase in employment generally. Nevertheless, Government is still also operating schemes to meet special difficulties, eg Youth Opportunities Programme, Temporary Short-Time Working Scheme. Expansion of these announced by my rhF Employment Secretary on 21 November. Expenditure on special employment measures over £1 billion (cash) in 1981-82 on present plans.

14. Outside forecasters generally expect unemployment to rise?

[Most outside forecasters foresee around 2¾ million (narrow definition) by Q4 1981; NIESR see a further rise to over 3 million by end 1982. CEPG forecast about 4½ million by 1985. Only LBS, of major forecasters, see any prospect of unemployment falling before late 1982.]

Unemployment is very difficult to forecast, but always tends to lag behind changes in output, which now appears to be bottoming out.

(b) [illegible] unemployment [illegible] in the country?

That would [illegible] unemployment [illegible] in our case [illegible] only [illegible] aspect of [illegible].

[illegible] of the unemployed?

[illegible] unemployment and [illegible] Treasury [illegible] published [illegible] an additional 100,000 [illegible] private [illegible]. This would [illegible] assumptions [illegible].

12. [illegible] public money [illegible] rather than [illegible]?

[illegible] Government [illegible] unemployment [illegible]. [illegible] public sector jobs without incurring significant net costs to the [illegible] attract people to take work, and likely [illegible] there would be a net cost to Exchequer and [illegible] moderation in wage settlements. Government [illegible] people [illegible].

[illegible] Government not doing more to provide more jobs?

Government is pursuing firm fiscal and monetary policies to [illegible] inflation and [illegible] conditions for regeneration of the supply side of the [illegible] economy. [illegible] measures that will ensure a sustainable increase in employment generally. Nevertheless, Government is still also operating schemes to meet special difficulties ([illegible] Community Programme, Temporary Short-Time Working Scheme). Expansion [illegible] announced by [illegible] Employment Secretary on [illegible] December [illegible] employment measures over £1 billion (cash) in 1981-82 [illegible].

14. [illegible] employment [illegible]

[illegible] million [illegible] million [illegible]

[illegible]

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D TAXATION

GENERAL

1. Burden of taxation

The only sure way to get the tax burden substantially lower is to conquer inflation by maintaining control over the money supply and public borrowing. This has meant a higher overall tax burden in the short run.

[Background information: total taxation, as a percentage of GDP at market prices, has risen and is forecast to rise as follows:

| | | | Per cent |
|---|---|---|---|
| 1978-79 | 1979-80 | 1980-81 | 1981-82 |
| 35 | 36½ | 38 | 40] |

2. Tax increases regressive?

No. The largest cuts in real income fall on those with very high incomes.

3. Take-home pay reduced for everyone by Budget?

True. But Budget must be viewed in the context of the rise in real personal incomes over the last three years, when real output increased only marginally. Between 1977 and 1980 real after-tax income of individuals rose by 17 per cent.

4. Budget reverses move away from taxing income to taxing consumers' expenditure?

No. Both income tax and expenditure taxes were increased in the Budget. Balance between total taxes on consumers' expenditure and total taxes on personal incomes is expected to be about the same as this year.

5. Budget hits incentives?

For the bulk of working population marginal rates of income tax will be unchanged next year.

INCOME TAX

6. Fairer to index the personal allowances fully and raise the basic rate?

This would have different effects at different points on the income scale. It is true that it would have benefited those on smaller incomes. It would also have helped those on very high incomes - because of the indexation of the higher rate scales. But a large number of people on middle incomes would have been worse off.

7. Dishonest not to index personal allowances?

To index personal allowances would have cost £2½ billion. Circumstances did not permit such a large injection of resources into the personal sector this year. But nothing "dishonest" about this. Following the procedure laid down in last year's Finance Act, a Treasury Order, setting out what the increases in the allowances and thresholds would have been if indexation had been possible, was made on Budget Day.

8. Widows and single women aged 60-65 will suffer from failure to index allowances?

There is a small overlap between pension levels and the single person's tax threshold. But the Inland Revenue's assessing tolerances will ensure that no widow or single woman whose sole income is her basic pension will have to pay tax this year. [FOR USE IF PRESSED: It is true that some of these women will have additions to their basic pension which will bring them into tax, but the number is nothing like the 600,000 figure that has been quoted (by Jeff Rooker).]

CAPITAL TAXES

9. Capital taxes - general

It was not possible to make major changes to capital taxes at a time when we had to increase the burden of income tax. But we are making a number of changes to encourage lifetime giving and new entrants to farming, and to counter certain avoidance of CGT.

INDUSTRY AND BANKS

10. Not enough tax relief for industry in the Budget?

Despite the tight constraints, the direct help given to industry in the Budget has been considerable and under-estimated. In addition to the 2 per cent reduction in MLR (worth around £700 million off companies annual interest charges on bank borrowing) the Budget gave a major concession on stock relief (costing some £450 million in a full year) and help worth £120 million to help keep down industrial gas and electricity prices.

11. Why tax the banks?

In contrast to manufacturing industry most banks have had two very good years, largely because of high interest rates. The extra revenue will be available to help hard-pressed sectors of industry.

NORTH SEA

12. New North Sea tax and PRT relief changes unfair?

Need to strike fair balance between nation and companies in sharing fruits of North Sea. Changes should not deprive companies of a fair return on North Sea projects and exploration.

PRT changes necessary to improve incentives to cost control.

INDIRECT TAXES

13. Indirect tax increases inflationary?

True that the indirect tax increases are expected to add two percentage points to the RPI. But by reducing public borrowing, they will help to bring inflation down in the longer run and ensure that it stays down.

14. Why not reduce NIS?

Unchanged rate (of 3½ per cent) necessary to meet PSBR target - reduction of 1 percentage point would cost the revenue equivalent to 1p on basic rate of income tax in a full year.

15. Why not reduce fuel oil duty?

Government is fully aware of pressure. Reduction in cash terms not possible if PSBR targets to be met, but real burden has fallen by some 15 per cent over the last year.

16. Vehicle Excise Duty

Increases (of 15 per cent) do no more than re-valorise the rates on all vehicles. Increased costs for business from VED and road fuel duties spread thinly; and substantially move the heaviest lorries towards covering their allocated road costs in line with Armitage Committee recommendations.

17. Petrol Taxation

The petrol and derv duty increases are an essential part of the strategy for reducing the PSBR and so containing inflation in1981-82. They will raise a total of £1180 million additional revenue a year (petrol £910 million, derv £270 million). The tax burden on petrol and derv is still lower in real terms than it was when the Conservative Government came to office in June 1970.

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# E PUBLIC EXPENDITURE AND FINANCE

## GENERAL STRATEGY IN PUBLIC SPENDING

### 1. Outturn in 1980-81

Outturn for planned expenditure in 1980-81 is expected to be some £94 billion in cash terms. This compares with a figure of £91.6 billion given in last year's FSBR.

### 2. Are not planned totals for 1981-82 already higher than in the new White Paper?

White Paper planning total for 1981-82 will be increased by £240 million (at 1980 survey prices) or ¼ per cent, because of Budget measures on industrial energy prices and the contingency reserve. In later years the effect of these changes will be a charge on the contingency reserve; they will therefore not affect the totals for those years. The proposed gas levy and oil taxation measures will also increase public expenditure (through their effect on EFL's of BGC and BNOC respectively) but not the PSBR.

### 3. Why is cash total for expenditure in 1981-82 £6 billion higher than forecast a year ago?

[paragraph 24 of MTFS on page 19 of FSBR]

As we made clear in the FSBR, a substantial part of the increase in the forecast of expenditure in both 1980-81 and 1981-82 is attributable to the recession being worse than expected, with spending on social security benefits, special redundancy payments and in 1981-82 external financing limits especially affected.

### 4. Big increase in total compared with last White Paper shows that Government is failing to reduce public expenditure?

Plans for coming year (1981-82) are still nearly 5 per cent lower than in the previous Government's plans.

### 5. Why not sufficient cuts to hold expenditure to the March 1980 White Paper figure?

Substantial further cuts were announced in November 1980 amounting to some £1½ billion cash for 1981-82, besides the major reductions in the European Community contribution. But they have been overlaid by the effects of the recession, and the consequent upward pressure on spending has been more severe than expected.

### 6. How much higher is public spending than Government would wish?

I cannot go beyond what is said in the White Paper. We are going to have a further look at this. I cannot put a precise figure on it. It depends on tax policy and the PSBR. What is clear is that the projected level of public spending implies a tax burden significantly higher than the Government would wish.

7. Further cuts?

My rhF the Chief Secretary made the position quite plain when he said in the House on 11 March: "It is disappointing that the recessionary effects and other increases have meant that even in 1982-83 we shall not have secured all the reductions in spending which we had hoped for last year. So we shall be having a very careful look in the coming annual Survey to consider whether more can be done to offset the increases that have occurred, and make more progress towards our original targets over the next three years."

That is true. I endorse it.

8. Does this mean there will be more cuts?

It means we shall be looking very hard at the possibility of further cuts.

9. For which years?

The plans for 1982-83 onwards will be reviewed in this year's normal annual Survey of expenditure.

10. Moves to cash planning announced in Budget mean that Plowden system is being abandoned?

Government does recognise case for medium term planning. But it must be planning in relation to the availability of finance as well as in relation to prospective resources. It is an illusion to suppose that there can be an unconditional commitment to forward plans for services.

11. Ratio of public spending to GDP is getting back to the peak levels of the mid 1970's

The ratios in 1980-81 (44½ per cent) and 1981-82 (45 per cent) remain below the level of 1974-75 and 1975-76 (46½ per cent in both years). The large rise from 41½ per cent in 1979-80 is partly because of the "relative price effect" and partly because the volume of expenditure rose 2 per cent at a time when real GDP fell by about 4 per cent.

12. How does Government justify cutting capital expenditure by more than current, and the continued decline in both public sector fixed investment and construction expenditure in 1981-82?

Over-riding need is to contain the upward pressure on public expenditure, which is already higher than Government would wish. The allocation of cuts between programmes reflects service needs and priorities, and these must ultimately determine the balance between current and capital expenditure.

13. How is the expected reduction over the Survey period in nationalised industries' total financing requirements to be achieved?

Reduction reflects continued application of economic pricing policies and improvement in performance by current loss makers. (eg steel, shipbuilding). Projections are inevitably uncertain since internal resources are affected by general trading conditions. For that reason the forecasts neet to be re-assessed annually.

14. Is Government still giving priority to the NHS?

Yes; this is one of the programmes where increases in spending are planned.

LOCAL GOVERNMENT

15. 1981-82 Rate Support Grant settlement

For local authority current spending in the next financial year we are seeking a reduction of about 3 per cent in volume compared with the level we planned for the current year. Rate Support Grant has been calculated on the basis of providing 60 per cent of the reduced volume of spending in England and Wales (this is 1 per cent below the 61 per cent in recent RSG settlements).

16. Implications for rates?

Rates increases in 1981-82 need not be excessive - despite lower RSG support - if councils plan in line with cost targets on volume, and stick to tough pay bargaining. The blame for high rate increases should therefore be put squarely at the door of the local authorities concerned.

17. What about local authority expenditure in the later years?

Local authority current expenditure relevant for rate support grant is planned to fall by about 1 per cent in 1982-83 and a little over ½ per cent in 1983-84. Local authority capital expenditure (excluding housing) is planned to fall 3 per cent in 1982-83 and 4 per cent in 1983-84.

18. What about the future of rates?

As a tax they suffer from many disadvantages. It would in many ways be desirable to abolish domestic rates at least. But this could not be done quickly or easily, and I therefore see no immediate prospect of being able to do it.

PUBLIC SERVICE PENSIONS

[Report of inquiry into value of public service pensions published 5 February; PM has said that Government will take account of reactions before making any decisions. For questions about index-linked gilts refer to H9].

19. When will Government take decisions on public sector pensions/what does Government intend to do?

Scott Report does not give an easy answer to the problems of occupational pensions in the public and private sectors. Government needs time to examine suggestions made in the Report and to consider public reaction before deciding what future arrangements could be made. We would particularly welcome views from the private pensions industry.

CASH LIMITS

20. 6 per cent on pay and 11 per cent on prices for NHS and civil service cash limits?

On 24 November we announced cash limit factors for the rate support grant and universities to provide for 6 per cent annual increase in earnings from due settlement dates, and 11 per cent increases in prices between the average level of 1980-81 and 1981-82. We said then that the pay of groups in other areas would be dealt with broadly within the same financial disciplines. The 18 February announcement gave effect to that.

21. The 6 per cent is a pay norm?

No. The outcome of settlements in particular cases will depend on the way in which the cash is allocated. Increases in earnings could be above and below 6 per cent; if they are above, it will be necessary to make offsetting savings eg through further manpower economies.

22. Staging pay awards

Staging can be a way of avoiding the discipline of cash limits. The Government will discourage staging or delaying implementation of pay awards. Cash limits will be set to ensure that no financial advantage can be gained in this way.

CONTINGENCY RESERVE

23. Revisions to nationalised industries 1980-81 EFLs - direct increase in public expenditure?

Money for British Steel, British Shipbuilders, British Rail, British Airways and British Telecoms increases has been found from Contingency Reserve; so does not add to planned spending or PSBR.

# F SOCIAL SECURITY

## SOCIAL SECURITY BENEFITS

1. Government has reneged on the PM's commitments to maintain the real value of pensions?

[Chancellor announced in Budget Speech that pensions and most other social security benefits will be uprated in November 1981 by about 9 per cent, ie one percentage point less than expected movement in prices between November 1980 and November 1981] Child Benefit, One-parent benefit, mobility allowance and invalidity allowance all being increased by more.

Government has not gone back on commitments. Benefits were increased by 16.5 per cent from November 24 1980. This is more than 1 per cent above the year-on-year rate of inflation (November 1980-on-November 1979 was 15.3 per cent). The effective 1 per cent abatement in the 1981 uprating will simply ensure that real value of pensions has been maintained over time.

2. Government attacking those most in need?

No. In a year when earnings are expected to rise by less than prices, those on benefits cannot expect to be better off than those in work.

3. Government should legislate to ensure that shortfalls in future upratings will be restored?

I have given a clear undertaking that over the lifetime of this Government any shortfall in relation to the level of prices will be made good for pensioners and other long-term beneficiaries. This pledge has been reiterated by my rhF the Social Services Secretary. We already have statutory power to make good shortfalls. The will and the means are already there; nothing new is needed.

4. Why not restore April 1979 value of CB?

Cost would be about £675 million in a full year. As it is, CB is being increased by about 10½ per cent, which is more than other benefits are being increased by and above the expected rate of price increase.

5. Petrol tax increase detracts from value of increase in mobility allowance?

Increase this year, as last year, is above expected rate of price inflation, in recognition of rising transport costs.

6. <u>What benefits are to be brought into tax by this year's Finance Bill?</u>

Benefits paid to the unemployed, temporarily stopped and in respect of families of strikers. Proposal fulfils a Manifesto commitment.

7. <u>When will other short-term benefits be brought into tax?</u>

Taxation of other short term benefits, including invalidity benefit, deferred to a future date.

8. <u>When will Government re-introduce proposals for a statutory (employers') sick pay scheme?</u>

In next Session. This will give more time for considering how employers' costs from the new arrangements may be offset.

9. <u>Low up-ratings, higher NI contributions and non-indexed tax thresholds combine to worsen poverty trap?</u>

Effect in any particular case will depend on type of employment, income and family circumstances. Families benefit from increases in CB and FIS.

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## G PUBLIC SECTOR BORROWING

1. PSBR in 1980-81?

[FSBR shows PSBR in 1980-81 of £13½ billion, 6 per cent of GDP, implying a small surplus for the January-March quarter.]

The estimated outturn is £13½ billion.

2. CGBR in March will be £½ billion?

[FSBR shows CGBR in 1980-81 of £12¾ billion; April-February figure - also published 10 March - implies March CGBR about £½ billion. Civil service unions claim £920 million payments frustrated so far [CONFIDENTIAL NOT FOR USE: Assessment about right but there are offsetting effects.]

A CGBR of about £½ billion is thought a reasonable estimate but may obviously be affected by events. It is not possible to assess the effect on the CGBR in this financial year of the present industrial action by certain civil servants, but the CGBR will be higher.

3. Why PSBR in 1980-81 higher than the £11½ billion given in November?

There has been a shortfall in the level of estimated revenue receipt and greater borrowing by the local authorities and public corporations.

4. PSBR in 1981-82 too high/low?

[FSBR forecasts PSBR of £10½ billion, 4¼ per cent of GDP . Direct effect of Budget measures reduces PSBR by £3¼ billion.]

The PSBR reduction in 1981-82 is in line with our medium term strategy objectives. It is necessary to continue our fight against inflation.

5. Public expenditure out of control in 1980-81?

[FSBR shows public expenditure planning total of £93¾ billion up £2¼ billion on last year's Budget estimate.]

Various factors contributed to the higher than planned expenditure. The depth of the recession led to particular forms of expenditure being high - unemployment benefit, special employment measures etc. Measures will be taken to tighten control in the future.

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# H MONETARY AND FINANCIAL POLICY

[New target set in Budget Speech: £M3 growth of 6-10 per cent (annual rate) for 14 months from February 1981 to April 1982 (unchanged from target in MTFS set out in 1980 FSBR. £M3 grew 0.9 per cent in banking February - taking growth since mid-February 1980 to around 20 per cent. Growth in last three months is 9 per cent at an annual rate.]

## 1. Targets discredited?

Monetary targets continue to play a central role in setting framework for policy. Essential to maintain downward pressure on monetary growth, the key to long-term reduction in inflation.

## 2. Costs of tight monetary policy too high?

Costs of not having a responsible monetary policy would ultimately be higher.

## 3. Monetary policy too tight pushing up exchange rate

As TCSC acknowledge, monetary policy has been tight, deliberately so, but view that this has been dominating influence in behaviour of exchange rate is controversial, although factors affecting exchange rate not fully understood. There are other explanations eg North Sea oil, current account strength. Interest rates seem to have been less important.

MONETARY CONTROL

## 4. Move to Monetary Base Control?

Position remains that we want to learn from experience of new procedures and the new statistical series before making any decisions. Our measures are consistent with evolution towards monetary base control and justified in their own right.

## 5. Defects of £M3

In 1980-81 was distorted by ending of corset, but will never be a better measure as a result. Not relying exclusively on £M3 for determination of interest rates. But remains best basis for medium-term programme.

FUNDING

## 6. Increased National Savings will affect competitors

No indication that increased flow into National Savings generated by measures taken since November have caused serious problems for institutions competing for savings. Building society receipts have remained high. National savings share of personal savings had fallen, our policy aimed at ensuring that personal sector once again makes an appropriate contribution.

7. BNOC bonds irrelevant to privatisation?

Government has Bill before Parliament which includes power to sell BNOC upstream assets. Bonds are first opportunity for small savers to share directly in benefits of North Sea oil.

8. Indexed gilts bad for inflation

Demonstrates Government's confidence in strategy of bringing down inflation. Government not institutionalising inflation. On contrary, reliance on high fixed coupon long-dated stock gives the greatest incentive to a Government to let inflation rip, to reduce the real burden of debt interest.

9. Indexed gilts a response to Scott?

The move has not been prompted by Scott report's recommendation and the planning of the issue was undertaken long before Scott reported. Initiative taken in context of moves to improve our techniques of monetary control, though there may in the longer term be benefits in pensions area.

10. Restrictions on holdings unfair to life insurance industry?

Eligibility provisions are designed to ensure that indexed gilts will not stimulate unwanted inflows from abroad. Within this context, intention has been to include life offices as far as possible, not to discriminate against them.

SELECT COMMITTEE MONETARY REPORT

11. Monetary growth does not cause inflation

Committee accepts that over long term money supply and price level have moved together. Their doubts are in fact about whether there is a direct or simple relationship. Clear that monetary growth is a necessary condition for continued inflation and that only if it is successfully controlled can inflation be brought down.

INTEREST RATES

12. MLR cut too little too late?

Have reduced MLR by 5 per cent since last summer. Irresponsible to make cuts which are not justified by financial or moentary developments.

## J PRICES

[Latest information

RPI rose 12.5 per cent in 12 months to February. Increase in the index over the month was 0.9 per cent; increase over the last 6 months at annual rate was 8.3 per cent (8.2 per cent excluding seasonal foods). Tax and Price Index rose 13.2 per cent in 12 months to February. Year-on-year increase in wholesale output prices to February 1981 was 10½ per cent - last six months at annual rate 8¼ per cent, the increase of 2½ per cent in the last 2 months has been due to the usual annual bunching of price increases, not to any increase in underlying trend. Wholesale input prices year-on-year increased 7¾ per cent - increase over last six months at annual rate rose to 11 per cent largely due to rising crude oil prices. For latest Industry Act forecast of RPI see Section B.]

### 1. The Budget will substantially increase inflation?

[Budget will add 2 per cent to the RPI and 2.3 per cent to the TPI. Net difference of these from revalorisation of taxes is 1 per cent on the RPI and 3.6 per cent on the TPI.]

Higher indirect taxes are necessary to reduce the level of government borrowing and bring the money supply under control. This is the only way to ensure a lasting reduction in the rate of inflation.

### 2. Inflation trends?

Year on year increase in RPI has been falling since May 1980, is now 13 per cent, and the trend is downwards. The Treasury forecasts published with the Budget are that the year-on-year rate will fall to 10 per cent by Q4 this year and to 8 per cent by Q2 1982. Change in TPI by Q4 1981 estimated at 13-13½ per cent (Parliamentary Answer given Mr Wheeler 18 March).

### 3. How does the trend compare with 1980 Budget forecast?

Increase in prices has been less than forecast.

### 4. When will it come down into single figures?

Many forecasters predict single figure inflation by end of 1981. This is well within the margin of error in the Treasury forecast.

### 5. Importance of realistic pay settlements

The rate of inflation is ultimately determined by the growth of the supply of money in the economy. But realistic pay settlements, which reflect what the country can afford, are essential if the rate of inflation is to be reduced as quickly as possible. Excessive pay increases will merely slow down the fall in inflation, leading to an additional, and wholly unnecessary, increase in unemployment.

6. But rate of inflation still far higher than when Government took office?

When we came into office inflation was already on a rising trend. That trend has now been reversed. Since May 1980 the year on year rate of inflation (RPI) has fallen from 21.9 to 13.0 per cent. Underlying six-monthly annualised rate of 10 11 per cent.

7. Government is adding to inflation? High interest rates have put up industry's costs. High interest rates have put up mortgages?

/Nationalised industry prices up 26 per cent in last year; further increases due in rail, coal, gas, phones. Housing (local authority rent and mortgage rates) up 18 per cent in last year. The mortgage rate is coming down to 13 per cent. In the main, benefit will be felt in April. MLR stood at 17 per cent from 15.11.79 to 3.7.80, 16 per cent to 24.11.79, 14 per cent to 10 March; now cut to 12 per cent in the Budget.]

No. Control of inflation in the medium-term requires control of the money supply, and of Government expenditure and borrowing. This requires a realistic approach to pricing for nationalised industries and housing. High interest rates have been necessary to contain the money supply. Interest rates are now coming down and a further reduction (of one per cent) in the mortgage rate has recently been announced.

[For gas prices see also R6]

8. Relationship of sterling to "green £" putting up prices to consumers?

Some reports have exaggerated the effect.

K EARNINGS

[Latest information

[Year on year increase in the average earnings index fell 18.8 per cent in January compared with 19.7 per cent in December. Underlying rate of increase in earnings over the last year is around 17¼ per cent. For briefing on the pay element in cash limits, see section E].

1. Is the private sector showing any restraint?

It is clear that private sector pay settlements will be much lower this year than during the last pay round. Latest CBI Databank survey suggests that the level of settlements in manufacturing industry is continuing to fall, and has averaged between 8 and 9 per cent between November and February.

2. Earnings figures belie low settlements?

The timing of pay settlements is such that settlements in the current pay round have so far had only a limited effect on the year-on-year increase in the average earnings index. But the figures show that average earnings rose by an underlying rate of 0.8 per cent a month between August 1980 (start of current payround) and January 1981 - about half the average rate in first half of 1980.

3. CBI figures for pay settlements in manufacturing in February

[CBI figures for February show ⅔ of all settlements in the month in single figures]

Figures recently published by CBI very encouraging. Demonstrates that there is now a realistic approach to wage settlements.

4. Government wants middle-single figure settlements?

[Chancellor's appearance at TCSC Wednesday 25 March].

The Government wants settlements that help to reduce costs and improve competitiveness - and, in the public services, that the taxpayer can afford. Obviously if the average level of pay settlements continues to fall to mid-single figures, the prospect for jobs will be correspondingly better.

5. Does the Government plan a 6 per cent pay norm for public services in the next pay round?

There is no question of a rigid norm. There is no decision yet on the increase the country can afford in the public service pay bill as a result of settlements from August. As the Public Expenditure White Paper makes clear, the provisional working assumption is a provision of 6 per cent. Whatever figure is finally decided will not be a limit on settlement levels but on the pay bill.

6. Increase in public sector pay bill in 1980-81?

The total public sector pay bill in 1980-81 is liable to be about 25 per cent higher than the previous year. This is double the expected increase in the pay bill for the private sector.

7. Public service pay policy? Unfair on public services?

No. Pay settlements must be negotiated in the light of what the country can afford. Ability to pay has to set the framework for pay negotiations in the public service as in the private sector. Public service workers had high pay increases last year and must contribute to the fight to contain inflation.

8. Pay in the nationalised industries

The Government has made clear the need for significantly lower pay settlements across the economy in the current round, given the Government's monetary policies and the need to avoid further erosion of competitiveness. This was very much in the Government's mind in their approach to setting external financing limits (EFL's).

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## L BALANCE OF PAYMENTS

[Latest information

Current account surplus of £614 million in February, £2.2 billion for the three months December to February. Surplus in 1980 £2.4 billion, made up of trade surplus of £1.2 billion and invisibles surplus of £1.2 billion. New Treasury forecast for £3 billion surplus in 1981 and even balance in first 6 months of 1982. Latest capital account figures show large new outflow on capital account in second half 1980, reflecting turnround in current account.]

### 1. Recent trade figures?

Our large recent surpluses contrast sharply with the large deficits of many other large countries and can hardly be regarded as bad news. The February figures show a rise in imports from last month's exceptionally low level and the continuing importance of oil (with its surplus of £476 million over the past three months) to our trading performance.

### 2. Main features of figures for balance of payments in Q4 1980?

The main features are the large net outflows shown in the capital account, probably accounted for by portfolio investment overseas and sterling lending overseas (although also reflecting revised statistical methods adopted during the year). Inflows into private and official sterling balances appear to have slackened in the fourth quarter.

### 3. Why the increased projection for invisibles?

The invisibles projection has been revised upwards on the basis of figures now available for Q4 1980 and takes account of our increased European Community Budget rebate.

### 4. Selective import controls?

[Proposed by TUC to reduce unemployment]

We already take action against dumping and to protect particularly hard-hit UK industries from disruptive imports. But any widespread resort to protection would encourage inefficiency among domestic producers and limit choice by consumers; it would also invite retaliation against our exports - as in the case of Indonesian textiles. There would be no long-term benefit to employment in the UK.

## M FOREIGN EXCHANGE, RESERVES AND IMF

[Latest information

The dollar began slightly weak as a result of low interest rates but strengthened towards the end of the week on higher interest rates and anxiety about Poland. Sterling has been in official and commercial demand, although the markets have generally been quiet. In the EMS, the lira has been devalued by 6 per cent. The closing rate on 27 March was \$2.23, 4 cents down on the previous Friday, with an effective rate of 100.38. (Highest rate against the dollar in recent months was \$2.45 on 21 October 1980.) Reserves at end-February stood at \$28.43, compared with \$28.39 billion at end-January.]

### 1. Exchange rate policy?

Government's policy is to leave exchange rate to be determined by the market. The current level has not been sought as a matter of deliberate policy. Whether the rate is rising or falling, intervention is limited to "smoothing", to moderate excessive fluctuations and preserve orderly markets.

### 2. Will Government act to bring rate down?

Experience has shown that to control exchange rates, Governments would have to cease to give priority to monetary targets. Sustained intervention by the authorities in the foreign exchange markets would risk adding to the money supply and jeopardising the fight against inflation - and even then could not guarantee a lower exchange rate.

### 3. Level of exchange rate endangering competitiveness?

Government recognises problems faced by industry, but excessive pay settlements are main cause of loss of competitiveness. Best remedy is therefore to control domestic costs through higher productivity and sensible pay settlements. Strong pound has contributed to recent sharp reduction in inflation rate; this should make it easier to achieve sensible pay settlements.

### 4. Reasons for recent strength of sterling?

Important factors contributing to the fundamental strength of sterling are the UK's position as an oil producer at a time of uncertainty in the world oil market, confidence in Government's commitment to defeat inflation, and continuing current account surpluses. In the period of the run-up to the Budget, the rate fell on expectations of a cut in MLR, but it has since risen slightly.

### 5. Future course of rate?

Following abolition of exchange controls, private sector outflows are growing and could accelerate as UK interest rates decline. Overseas borrowing in sterling market could also expand. Meanwhile, the exchange rates of other developed countries should strengthen as their balance of payments recover from the oil price rise of last two years. Over time, these factors should offset some of upward pressures on the rate - but Government is making no predictions.

6. Inflow controls?

The experience of other countries is that controls on inflows are unlikely to be effective for more than a short period. In view of London's sophisticated financial markets it would be especially hard to make controls effective here.

7. Debt repayments

It is the Government's intention to reduce the burden of external debt substantially during this Parliament. Since the Government took office, we have made net repayments of \$4.4 billion of foreign currency debt. During this year we intend to prepay the \$2.5 billion Eurodollar loan (raised in 1974) and to continue with other scheduled repayments. By the end of 1981 our total outstanding external debt will be down from its present level of \$18 billion to stand at \$14 billion.

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# N EUROPEAN MATTERS

## COMMUNITY BUDGET DISPUTE

1. What action is being taken on the refusal by certain member states to make the full contribution requested by the Commission?

The Commission has initiated the action provided for in the Treaty. Germany has itself referred the matter to the European Court. I do not think it would be right for me to speculate on what the Commission, or other member states may do next.

2. UK satisfied that budgets were legally adopted?

The Commission decided that the budgets were legally adopted and requested payment accordingly. HMG saw no good reason not to comply. We regard the allegations of impropriety as unproven.

3. Will dispute delay budget refunds?

There is no reason why it should. We received advance payments of about £97.6 million from the 1980 budget on 31 December. We have so far this year received payments totalling £270 million.

4. How large were the recent payments by the UK?

On 2 January we contributed approximately £35 million as our share of the 1980 supplementary budget. Well over three-quarters of the supplementary budget provision is earmarked for the Social Fund, from which the UK is a net beneficiary, and most of the rest for disaster relief in Italy. We paid £169 million in January towards the 1981 Budget.

5. How can similar disputes between the Council and Parliament be avoided in future?

At the Budget Council the FST called for a review of budget procedure with precisely this objective. Member states will undoubtedly be discussing the subject further.

## UK BUDGET CONTRIBUTION PROBLEM

6. How much money shall we get back in total?

We expect to receive net refunds of about £700 million in respect of 1980 and about £800 million in respect of 1981. If our unadjusted net contributions exceed those assumed in the 30.5.80 agreement, the refunds due will be higher. The precise sums will also depend on exchange rates.

7. When shall we get the money?

Over three-quarters of the estimated refund due in respect of a particular calendar year will be payable within the UK's corresponding financial year ie by 31 March of the following year. We expect to receive the remainder by the autumn of the same year.

8. What if we hit the 1 per cent VAT ceiling before 1982?

This is a Community problem to which a Community solution will have to be found. The Council will need to take action to curb the increase in the expenditures that are causing the problem.

9. Will there be any additional public expenditure as a result of the scheme?

There is additionality in the important sense that the refunds will make possible a higher level of public expenditure in the regions and elsewhere than would otherwise have been possible. Both the participating authority and other spending authorities will get the advantage of a higher level of expenditure than the country could otherwise have afforded. The scheme does not, however, open the way to increases in expenditure by participating authorities beyond levels already planned. In that sense there is no additionality.

10. Will the supplementary measures scheme give the Community undue influence over UK expenditure priorities and decisions?

No. The Community will be contributing to the financing of public expenditure programmes planned by public authorities in the UK and proposed by the Government for Community support. The Government will continue to decide the allocation of public expenditure between individual programmes.

11. What about the future?

The 30.5.80 Budget settlement provided for a radical review of the Community's budgetary arrangements and of the pattern of Community spending. If this review has not of itself solved the UK's budget problem by 1982, the Community is committed to extending the arrangements negotiated for 1980 and 1981.

EUROPEAN MONETARY SYSTEM

12. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

# P INDUSTRY

[Latest information

Gross trading profits net of stock appreciation (at current prices) of industrial and commercial companies (including North Sea oil) fell 5 per cent in six months to September 1980. In real terms the fall was greater. Net borrowing fell to about £1½ billion in the six months to September 1980, a fall of about £3 billion on previous six months; and was financed by increased bank borrowing. Company liquidity (DOI quarterly survey) for manufacturing companies increased again in Q4 and improved markedly for non-manufacturing. Overall liquidity ratio same at end-1980 as at end 1979. Company liquidations (seasonally adjusted) in three months to February 1981 are running 40 per cent higher than average monthly figure in 1980. Industrial and manufacturing production in three months to February were 2 and 3½ per cent below previous three months. Stocks fell by over £2 billion in 1980, compared with a rise of over £¾ billion in the latter half of 1979. Employment in production industries fell by 800,000 in the 12 months to January 1981.

## 1. Budget does not do enough for industry

Main priority remains reduction of inflation. Success of this policy very much in the long-term interests of industry. But one of aims of Budget to redress balance between personal sector and hard-pressed parts of business sector. 2 per cent reduction in MLR, implementation of stock relief scheme and further action on energy prices welcomed by industry. Scope for providing more assistance to industry limited by need to reduce PSBR, difficulties in reducing public expenditure during period of recession and Chancellor's desire to limit increases in taxation. [See also Section D on specific measures].

## 2. CBI criticism

[Figures published in CBI Press release 13 March accuse Chancellor of taking away some £500 to £600 million from business generally - apart from £400 million from banks, £1 billion from oil companies.]

CBI figuring has not taken account of all the reliefs provided notably effect of MLR cut. Restraining PSBR and lowering interest rates a better way of helping industry than indiscriminate tax cuts <u>and</u> higher borrowing. To extent extra tax revenue being sought, concentrated on those least affected by recession - oil companies, banks, and personal sector.

# SMALL FIRMS

## 3. Government help for small firms

Government has taken further major steps in the Budget to encourage enterprise in the important small firms sector: in particular the proposed Business Start-Up Scheme and the pilot Loan Guarantee Scheme. These measures - and the others which my rhF also announced in his Budget statement - are aimed at encouraging enterprise and risk-taking. My impression is that they have been very well received by organisations representing small firms.

4. Why is what little assistance the Government is providing to industry concentrated on small firms?

We believe that generally the best way to help industry is to create a business climate in which it can expand. But we believe that investment in small firms deserves specific encouragement, partly because they represent a major source of potential growth, and partly to overcome a traditional lack of interest in them among potential investors.

5. Why, under the Loan Guarantee Scheme, will borrowers have to pay a full commercial rate of interest? Would not a lower rate of interest have been a better incentive?

This is a necessary condition for an unsubsidised scheme. Our intention is not cheaper lending, but additional lending to finance worthwhile projects for which the necessary financing would not otherwise have been available.

GENERAL

6. "Will to Win" four years strategy document from CBI call for expansion/cry for help?

[Document published 5 March set out medium term economic strategy for four years to 1984-85, involving Government action costing £1½ billion a year (1981-82 prices) for each of the four years; forecasts GDP rising by 3 per cent a year from 1982 and unemployment down to 2½ million in 1985 if prescriptions adopted.]

Not a statement of policy but a discussion document intended primarily for CBI members. Government welcome CBI hard thinking about changes needed in period up to 1985 if British business is to play its part in restoring prosperity. Government recognises problems many parts of industry have been facing during present recession and, wherever possible, is giving priority to industry's needs. But best prospect of achieving sustained increase in output is to reduce inflation. Encouraging signs of success. Rate of inflation is now coming down and it looks as if worst of fall in output may soon be behind us.

7. TUC plan for £6 billion reflation?

The £6 billion reflation advocated by the TUC Economic Review would not constitute a solution to Britain's economic problems. It would be more likely to stoke inflation and such in imports. What is required is a sound monetary policy - the sort of policy pursued by countries like Germany and Switzerland with relatively low unemployment levels.

8. Liberal proposals for a positive industrial strategy

While not ruling out constructive interventionism at the margin, particularly in areas of high technology, we believe one of the main reasons for our poor industrial performance is that the 'invisible hand' of the market place has too often been obstructed by the very visible hand of bureaucracy. Accordingly, we totally reject all suggestions that Government should adopt a positive industrial strategy even in more tepid form proposed by Liberals.

9. Complaints from industry that poor performance is result of Government policies?

Government aware of and concerned about industry's problems. But figures reflect mainly long-run poor performance and excessive rate of wages increases. Government policies only way to reduce inflation and improve supply side of economy. I am sure industrialists do not want Government to abandon efforts to control public expenditure, PSBR and money supply.

10. Danger of industrial base being destroyed?

Some fall in industrial output is inevitable during the present recession. But in the longer term the Government's policies to reduce inflation and improve the supply side of the economy will provide the framework for sustained economic growth.

11. Energy pricing policy and industry

NEDC task force report on energy prices discussed at 4 March meeting. Showed that prices to vast majority of industrial consumers remained in line with Europe limited but important number of alrge users of electricity and gas paid more than European competitors. Electricity and gas industries have made proposals for additional relaxation in industrial pricing policy, particularly to large energy intensive users. My rhF announced in the Budget increases of £118 million in energy supply industries' external financing limits for 1981-82 to accommodate these measures. Government also committing £50 million over next two years for grants to industry towards cost of converting industrial oil-fired boilers to coal.

12. Movement towards cash-less payment of wages; Truck Acts

[CONFIDENTIAL - NOT FOR USE: Revised CPRS document now prepared; intention to publish fairly soon so as to stimulate public discussion]

Government believes there are a number of advantages in employees receiving their pay through banks or similar institutions rather than in cash, and monthly rather than weekly. Matter being actively considered.

ENTERPRISE ZONES

13. Progress with designation of Enterprise Zones?

Statutory invitations to prepare enterprise zones now issued to local authorities concerned for eight of the eleven zones - Swansea, Salford/Trafford, Dudley, Corby, Newcastle/Gateshead, Clydebank, Wakefield and Speke/Liverpool. Expect therefore that first zones should be in operation by summer.

[Note: Other three areas announced are Belfast, Isle of Dogs (in London's dockland) and Hartlepool].

## R NATIONALISED INDUSTRIES

### 1. Government policy on nationalised industries

To reduce State ownership and improve efficiency of publicly-owned enterprises. Market forces are to be brought to bear, and private capital is being introduced - where appropriate. Competition Act has been used to refer selected nationalised industry operations to the Monopolies and Mergers Commission. Reports have been published on British Rail's commuter services in the south east and on the Inner London Postal Service.

### 2. Increaseed NI investment would boost private industry and add to productive potential?

Depends on whether or not extra investment is accommodated within existing public sector totals. If it were allowed to add to borrowing requirement, it would tend to raise interest rates and discourage other expenditure, including some private sector investment. Except in short term, net effect on private sector might not be beneficial and effect on future growth of productive potential is uncertain.

### 3. Take nationalised industry investment out of the PSBR?

Since nationalised industries are part of the public sector, their borrowing - for whatever purpose - must by definition form part of the public sector borrowing requirement.

### 4. Finance nationalised industry investment from lower pay settlements?

Moderate pay settlements - in line with those in the private sector - are essential. It cannot escape those who seek greater investment in the nationalised industries that the chances of financing this diminishes if excessive pay settlements are agreed.

### 5. Alternative ways of financing NI investment, eg direct access to markets?

We have considered a number of proposals of this kind. Unfortunately none has yet met the key conditions, principally for there to be a genuine element of risk for the investor related to the performance of the enterprise, which would bring pressure for improved performance to bear on management, and the need to avoid excessive monetary growth. However, we are determined to continue searching for ways of achieving an acceptable method of allowing NIs to fund profitable investment from the market.

### 6. British Telecom to be allowed to borrow from the market?

Proposed power added to the British Telecommunications Bill purely permissive. No decision has yet been taken on whether such borrowing would be desirable, and it would in any case count against BT's external financing limits. Prior consent of the Treasury and the Industry Secretary would be required.

7. Would private borrowing by British Telecom be excluded from PSBR?

While BT remains a public sector body, its borrowing will continue to form part of the PSBR.

8. Tripartite meeting on coal industry

Further tripartite meeting was held on 11 March. NCB said broad estimate of cost of withdrawing accelerated closure programme and of reducing imports towards irreducible minimum would be £100-200 million in 1981-82. These costs will be met from the Contingency Reserve.

9. Cost of improvements in redundancy terms for coal miners

I am informed that the improvements in the Redundant Mineworkers Payments Scheme will cost between £10 million and £15 million a year at the present rate of closures.

10. Is the levy on British Gas (proposed in the Gas Levy Bill) behind the domestic price increases recently announced?

No. The announced increases (15 per cent in April, 10 per cent October) continue the move to correct the under-pricing of domestic gas, foreshadowed when the British Gas Corporation's financial target was set in January last year. The financial target will be adjusted to take account of the levy, which will not therefore affect gas prices.

11. Sale of nationalised industry assets (eg British Aerospace)?

The sale of public sector assets has a twofold advantage. First, management is subjected to the pressures of competition. Second, it contributes to the reduction of the PSBR and the control of monetary growth, which are essential to the Government's strategy against inflation. Recent announcement of sale of 50 per cent of shares in British Aerospace represents major step forward in this strategy.

S NORTH SEA AND UK ECONOMY

[Latest information: Direct contribution of North Sea oil and gas to GNP is estimated to rise from 3 per cent in 1980 to about 5 per cent in 1984; expected contribution to Government revenues estimated at £3¾ billion in 1980-81 and just under £6 billion in 1981-82 (at current prices). In constant 1979-80 prices, forecast to rise from £4½ billion in 1981-82 to £5¼ billion in 1983-84. Figures for 1981-82 and later years includes new tax - supplementary petroleum duty - and PRT relief changes announced in the Budget, estimated to yield £1 billion (at current prices) in 1981-82. These forecasts based on latest Department of Energy forecasts of oil production (published in Hansard on 5 March) and on a modest annual rise in real oil price from 1981. Less susceptible of measurement is boost given by North Sea to local employment and to industry in offshore equipment].

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

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Only one-twentieth of total general government receipts in 1981-82. They do not in themselves solve the deep-rooted problems of the economy.

2. Why have Government estimates of North Sea tax take been revised downwards?

Downward revision is largely the result of lower production and upward revision to forecast of capital expenditure in tax-paying fields. Higher-than-expected real oil prices insufficient to offset these depressing factors. (Treasury Press Notice of 10.3.81 gives more details).

3. Government forecasts of North Sea tax revenues unjustifiably gloomy to support policy of cutting public expenditure?

No. More the case that other forecasters are over-estimating future production in spite of persistent tendency for past forecasts to be over-optimistic. Some other forecasters are also predicting very high rates of increase in the real world price of oil and lower capital expenditure. (Treasury Press Notice of 10.3.81 gives more details).

4. New tax and PRT relief changes unfair?

Need to strike fair balance between nation and companies in sharing fruits of North Sea. Changes should not deprive companies of a fair return on North Sea projects and exploration. PRT changes necessary to restore PRT reliefs to original purposes to improve incentives to cost control and to tackle problem of excessively high returns to companies at Exchequer's expense of additional, yet not necessarily productive, investment.

5. What about stability assurances?

Fully appreciate importance of stability for industries with long lead-times for investment. But never ruled out change in any circumstances. Oil world, oil prices and UK economy have changed greatly since PRT introduced; changes have become too great for PRT to cope with. Changes still leave industry with fair return on investments.

6. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels. Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

7. North Sea revenues should be channelled into a special fund to finance new investment, particularly in energy?

[Speech by Chairman of BNOC, 18 March]

North Sea revenues are already committed. Setting up a special fund would make no difference. More money would not magically become available. So the money for this special fund would have to come from somewhere else - lower public expenditure, higher taxes or higher public borrowing.

8. UK residents should be given some kind of stake in North Sea operations?

Chancellor announced in his Budget that savers will have an opportunity to share in the benefits of the North Sea through an oil bond linked to the fortunes of BNOC. As for the powers to enable the sale of an equity stake in BNOC, I refer the questioner to my rhF the Chancellor of the Duchy of Lancaster on 26 March. We intend to reintroduce the Bill during the next Session.

9. UK's favourable position as an oil producer creates problems by pushing up exchange rate

North Sea oil is influencing the exchange rate, which is one of the mechanisms of structural change in an oil-rich economy. This emphasises the need for industry to respond flexibly.

10. North Sea oil will lead to sharp decline in British manufacturing industry?

[Energy Secretary referred in speech 10 February to Forsyth and Kay article of July 1980]

Forecasts that North Sea oil and the associated strength of the exchange rate will reduce the size of the manufacturing sector by 9 per cent are far too gloomy. Relative decline in manufacturing unavoidable; absolute decline not inevitable.

AIDE MEMOIRE ON THE UK ECONOMY 30 March 1981

PRESENT SITUATION

GDP output estimate fell 1½ per cent in Q4 1980: the average estimate fell 2 per cent between the years 1979 and 1980. Industrial output fell 2 per cent in the three months to January 1981 and was 11½ per cent below the same period a year earlier; manufacturing output fell 3½ per cent in the three months to January 1981 to reach a level 15½ per cent below the same period a year earlier.

Consumers' expenditure rose 1 per cent in Q4 1980: the average level in 1980 was about ½ per cent higher than in 1979. Retail sales fell in February but in the three months to February were 2 per cent higher. Volume of exports fell 2 per cent in the three months to February 1981 after being broadly flat since mid-1980. Volume of imports fell 2 per cent in the three months to February 1981 continuing the downward trend though suggesting some slowing down in the rate of decline. Manufacturing investment in 1980 after allowance for leasing is estimated to have fallen 6 per cent compared with 1979. Distributive and service industry investment (excl. shipping) rose 5½ per cent on the same comparison. DI investment intentions survey (conducted in October to December) suggests a fall of 15-20 per cent in manufacturing investment in 1981, with some recovery in 1982; distributive and service industries (excluding shipping) investment expected to be broadly unchanged in 1981 and 1982. Manufacturers' and wholesalers' stocks fell substantially in Q4 1980 to bring the total level of destocking in 1980 to £1.8bn (at 1975 prices). Retail stocks in 1980 fell by about £¼ billion (at 1975 prices).

Unemployment (UK, seasonally adjusted excluding school-leavers) was 2,380,800 (9.9 per cent) at March count, up 76,700 on February. Vacancies stood at 97,200 in March.

Wholesale input prices (fuel and materials) rose 1¾ per cent in February to stand 7¾ per cent higher than a year earlier; wholesale output prices ("factory gate") rose 1 per cent to stand 10½ per cent over a year earlier. Year on year RPI increase stood at 12.5 per cent in February compared to 13.0 per cent in January. Average earnings in January were 18.8 per cent higher than a year earlier. RPDI rose 2 per cent in Q3 1980. The average level in the first 3 quarters of 1980 was 2 per cent higher than the average level throughout 1979. Savings ratio rose to 17 per cent in Q3 1980.

PSBR was £12¼ bn (seasonally adjusted) in the first three quarters of 1980-81. CGBR was £12.2bn in the first eleven months of 1980-81 (not seasonally adjusted).

Sterling M3 rose 0.9 per cent in banking February. MLR reduced from 14 per cent to 12 per cent on 10 March.

Visible trade has been in surplus since mid 1980. Estimated current account surplus of £0.6bn in February 1981 followed a surplus of £1.0bn in January. Reserves at end-February $28.4 bn. At the close on 27 March the sterling exchange rate was $2.2295 and the effective rate was 100.4.

STEERING BRIEF

CONFIDENTIAL

Put all in my folder

1. MR HANCOCK
2. CHANCELLOR ~~cc as attached list~~

Do we need black tie, long dress?

NO LB 2/4.

1/4/81.

INFORMAL MEETING OF FINANCE MINISTERS : 3-4 APRIL

The meeting will take place in Breda (in the Netherlands) on 3 and 4 April. You will be accompanied by Lady Howe, the Governor and Mrs Richardson, and Sir Kenneth Couzens.

## Administrative arrangements

2. Your flight takes off from Heathrow at 0810 (HN404), arriving Rotterdam at 1005. The Embassy will take you to Breda where the meeting begins with lunch at 1230. The subsequent arrangements are shown on the attached telex. Your return flight is from Amsterdam departing 1800 (KL135) arriving Heathrow 1800. This will enable you to catch the 1937 train from Reading to Wales in time for your [evening] engagement next morning.

## Agenda

3. There is no formal agenda. However, we have provided briefing on the following topics:

- *(1) Preparations for IMF interim committee
- (2) Preparations for development committee
- (3) Macroeconomic policy and interest rates
- (4) Relations between EC and USA
- (5) Preparations for the 'Jumbo' Council
- (6) Export credits
- (7) Budget restructuring — I shd like some of D.'s earlier papers on this, with illustrative table(s)
- (8) Insurance services directive
- (9) Salaries of Community staff
- (10) Aid to Turkey
- *(11) Possible further EMS realignments
- *(12) Future informal meetings
- (13) Saudi quota increase
- (14) European Parliament extravagance

4. Items (1) - (3) and (5) - (6) are those mentioned in the Dutch telex as meriting "special consideration". The others are items which we think might come up.

## Objectives

5. Our line on items (1) - (5) and (10) - (11) is somewhat



* brief to follow tomorrow morning

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defensive - we wish to discourage new initiatives, avoid demarches etc. On the other hand we would recommend you to raise items (7) - (9) and (12) even if no one else does. Our line on item (6) is not defensive, but we would not recommend you to bring the matter up yourself.

Interim Committee (Brief 1)

6. Our main objective here is to get agreement that the Interim Committee in Gabon should be an opportunity for taking stock of the changes which have already taken taken place or been put in hand, rather than an opportunity for the fresh initiatives.

Development Committee (Brief 2)

7. Our objective is to avoid commitment at this stage to UK participation in the proposed new Task Force on Concessional Flows.

Macroeconomic policy and EC/US relations (Briefs 3,4)

8. Our objective is to oppose any renewed attempt for a Community demarche on the US to reduce interest rates and to counter unrealistic calls for a general reduction in interest rates. If interest rate policy is to be discussed, then it should be properly considered in the context of counter-inflation and fiscal policy.

Jumbo Council (Brief 5)

9. Our main objective is to ensure that the Jumbo Council does not take place under our Presidency (1 July - 31 December 1981). This is difficult to achieve directly, so it is perhaps best to leave others to make the running.

Export credits (Brief 6)

10. If this is raised, our objective is to emphasise the importance of avoiding a breakdown in the Consensus, but to add that we see dangers in making premature concessions to the Japanese.

Budget restructuring (Brief 7)

11. We recommend that you take the opportunity to make contact bilaterally with others at the meeting, especially the Germans and the Commission, to emphasise the importance which we attach to this subject and to endeavour to persuade them that the Commission's paper (promised for June) should contain a thorough and serious review of the options.

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Insurance services (Brief 8)

12. Our objective is to continue the political pressure for agreement which we began at the March FinanceCouncil.

Staff salaries (Brief 9)

13.. There is considerable evidence that the salaries of Community staff are too high. We would like to persuade Finance Ministers to put pressure on their Foreign Affairs colleagues to be firmer when they come to consider the recent Commission proposals on the method of reviewing staff pay.

Turkey (Brief 10)

14. We understand that Herr Matthofer is likely to press his colleagues to be generous at the forthcoming pledging session. We will have to make clear that it will not be possible for us to make a larger pledge than last year.

EMS (Brief 11)

15. It is possible that there may be some discussion of the need for a further realignment within the EMS in view of the pressure on the Belgian franc.

Further informal meetings (Brief 12)

16. You could take the opportunity to sound out your colleagues on whether they wanted a further informal meeting in the second half of the year.

J Scholes

J SCHOLES
1 April 1981

P.S. Personality notes & this weeks background brief for No 10 also attached. (Nos 15 & 16)

D.H.

1/4.

Sir K Couzens   c. PS/Gov
Mrs Hedley-Miller
Mr Mountfield
Miss Binnie

9
25.

TLXNR. 331-4269
THE HAGUE , 25TH MARCH 1981

TO SIR GEOFFREY HOWE
CHANCELLOR OF THE EXCHEQUER
TREASURY
LONDONNNNNNNNM

DEAR COLLEAGUE,

IN PREPARATION FOR OUR MEETING ON 3RD AND 4TH APRIL 1981 I WOULD INFORM YOU OF THE FOLLOWING. THE PROGRAMME PLANNED FOR FRIDAY 3RD AND SATURDAY 4TH APRIL IS AS FOLLOWS:

FRIDAY 3RD APRIL
================

| | |
|---|---|
| 12.00 | ARRIVAL AT HOTEL MASTBOSCH, BREDA |
| 12.30 -13.30 | LUNCH TO WHICH LADIES ARE ALSO INVITED |
| 14.00 -16.15 | MEETING AND SPECIAL PROGRAMME FOR THE LADIES |
| 17.30- 19.00 | COCKTAILS WITH GUESTS ~~FORM~~ FROM FINANCIAL CIRCLES IN THE NETHERLANDS |
| 20.00 -22.15 | DINER AT LOEVESTEIN CASTLE |
| 23.30 - | RETURN TO HOTEL MASTBOSCH |

SATURDAY 4TH APRIL
==================

| | |
|---|---|
| 9.30 - 12.00 | MEETING AND SPECIAL PROGRAMME FOR THE LADIES |
| 12.30 - 13.30 | LUNCH TO WHICH LADIES ARE ALSO INVITED |
| 14.30 - 15.30 | TOUR BY AIRPLAIN OF THE DELTAWORKS |
| 15.45 - 16.00 | CONCLUSION (AT AIRBASE GILZE RIJEN) |

THERE ARE A LARGE NUMBER OF SUBJECTS WHICH CALL FOR OUR ATTENTION AT THE PRESENT TIME. OF THE SUBJECTS TO BE DISCUSSED DURING THE COMING MEETING I WOULD ASK FOR SPECIAL CONSIDERATION TO BE GIVEN TO QUESTIONS SUCH AS THE FORTHCOMING MEETINGS OF THE INTERIM COMMITTEE AND THE DEVELOPMENT COMMITTEE IN GABON, THE GENERAL DIRECTION OF MACRO ECONOMIC POLICY OF THE MEMBER COUNTRIES, THE PREPARATIONS OF THE JUMBO COUNCIL AND POSSIBLY EXPORT CREDITS.

IF YOU INTEND TO ARRIVE BY PLANE AT THE GILZE RIJEN AIRBASE, PLEASE INFORM THE AIRBASE AS SOON AS POSSIBLE OF FLIGHTPLAN (IN CONNECTION WITH CROSS SERVICING). TYPE OF AIRCRAFT, AND INDICATE WHETHER SHELTERING IS NECESSARY.

I AM ASSURING THAT YOU WILL, IF NECESSARY, PASS ON THE INFORMATION CONTAINED IN THIS TELEX, TO GOVERNOR OF THE CENTRAL BANK IN YOUR COUNTRY.

FONS VAN DER STEE

331417 MIFI NL
331417 MIFI NLV

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Circulation

PPS
Financial Secretary
Sir K Couzens
Mr Byatt
Mr Hancock
Mrs Hedley-Miller
Mr Mountfield
Mr Unwin
Mr Ashford
Mr Bottrill
Mr Buckley
Mr Edwards
Mr Hawtin
Mr Peretz
Mr Atkinson
Mr Gieve
Mr Gilhooly
Mr Mercer
Mr Butt UKREP
The Governor B/E
Mr Balfour B/E
Mr Wentworth - Cabinet Office
Mr Spreckley - FCO
Mr Appleyard - Paris
Mr Beamish - Bonn
Mr Anson - Washington
Mr Adams - Rome

Steering brief only

CST
MST(C)
MST(L)
Sir D Wass
Mr Barratt

BRIEF No 1. 76

No. 1

INFORMAL MEETING OF FINANCE MINISTERS

IMF Interim Committee Agenda 3-4 April

Objectives

1. If it seems that M Monory (Chairman of the Interim Committee) is inclined to leap too far towards placating the developing countries, to try to encourage a more balanced approach.

2. To this end, to seek agreement that at the Interim Committee in Gabon the industrialised countries should try to ensure that full credit is given for all the changes that have taken place in the IMF in the last twelve months or so. The Fund has responded to the needs of the new circumstances. Evolution not revolution is clearly right.

3. To get agreement that the quite limited Interim Committee agenda proposed by the Managing Director is acceptable.

4. To get agreement that the industrialised countries must retain pre-emenance in the Fund.

5. To win EC partners' support for IMF borrowing from the market.

Points to Make

4. The proposed agenda for Gabon is about right. It includes, appropriately, a retrospect. There is no need to the defensive. Much has been achieved in the IMF since the Annual Meetings:-

(a) Encouragement for the SDR. Agreement to raise the SDR interest rate to 100 per cent of the market rate. Basing the SDR on 5 currencies rather than 16 has increased the attractiveness of SDR-denomination in the private markets.

(b) The possibility of borrowing much larger amounts from the IMF has become a reality. (Technically called "Enlarged Access", with an appropriate framework of rules).

(c) Financing is on hand to make "Enlarged Access" possible.

We have an agreement to borrow SDR 8 billion from the Saudis in return for an increase in their quota to $3\frac{1}{2}$ per cent. (Sixth in the batting order - ie the first after the big 5).

5. Specifically, the Fund has agreed several extended adjustment programmes with large LDC's (eg. Morocco, Pakistan, Bangladesh, Sierra Leone). This is encouraging. It indicates that conditionality (reviewed in 1979) and the shape and size of Fund adjustment loans (reviewed last year) are attractive to potential LDC borrowers, while still providing the 'seal of approval' which many commercial bankers seek before committing themselves to loans or loan rescheduling.

6. Evidence of all this Fund movement and adaption should be used to the best advantage in bilateral or multilateral contacts with developing countries. We can show that many G24 demands have been met in substance (not only the four listed in paragraph 4 above, but others including interest subsidies on lending under the Supplementary Financing Facility and removal of SDR reconstitution requirement).

7. But we will have to look very carefully at where we are going on the outstanding G24 point - voting power in the IMF. No immediate decisions needed: the Eighth Quota Reivew is only just beginning. But it is crucial to the future of the Fund that it should not tumble into the control of the LDC's. This would not serve even their interests in any way. So if the moment comes when the industrialised countries have to make a stand we must choose the sticking place carefully and not be pushed on from one "sticking point" to the next.

8. Sources of finance for the Fund. Much better if IMF could rely mainly on its own resources, without a need for substantial borrowing. So we must make the outcome of the Eighth Quota Review a really big increase on the size of the Fund. But, like it or not, there is no escape from Fund borrowing in the next few years: the Fund must help the recycling process, and has at least some chance of ensuring policy adustments to the economic realities of the period ahead. Borrowing direct from the OPEC surplus countries has been the Community's generally favoured course. But the

present Saudi episode suggests that it is not comfortable for the Fund to get dependent on a single country. Some market borrowing to supplement bilateral borrowing would reduce this dependence, as well as providing a measure for the appropriate terms of borrowing. And it would do something to get SDR denomination better known in the private markets. Hope colleagues willing to look at market borrowing by the Fund in this rather more favourable light. There may well be a need in 1981, in spite of SDR 4 billion from the Saudis this year.

9. Harnessing the Saudis. By gaining sixth place in the Fund the Saudis have taken on responsibilities. They are now more than mere providers of money. Important that industrialised countries draw the Saudis more fully into discussion on international monetary affairs. We hope that industrialised countries will reflect on how this can best be done.

10. Further SDR Allocations in the period 1982-86 may be raised at Gabon, but this will hinge on the US attitude, which is at present strongly hostile. Community will have to consider whether it is going to accept the US view that further allocations are inconsistent with our anti-inflationary posture, or whether we should urge a modest allocation for the sake of temporary peace and quiet. British incline to the former view. Either way the Fund should do some honest thinking about the SDR and its role: it was conceived in the fixed rate system, and fits much less easily into the present floating rate regime.

Background

11. A copy of the draft agenda for the IMF Interim Committee in Gabon is attached. It is not very exciting. It is not clear yet what direction the Fund's 'World Economic Outlook' is likely to take, though it seems likely that attention will continue to be focussed on the fight against inflation despite the interim costs of the struggle in terms of lost output and employment, and the ability of LDC's to afford the financing of their projected deficits.

12. The discussion of Fund policies will cover work set in hand at the last Interim Committee. On Enlarged Access and Fund Borrowing, the MD will report the recent Saudi deal and the moves to secure short-term loans from Central Banks either bilaterally or through the BIS. The UK is willing to contribute subject to clarification of the precise terms and amount and would probably do so bilaterally rather than through the BIS. The Community colleagues will stress the need for the Americans to find a way of contributing, preferably now, but certainly later. This is certainly desirable, though one can see that if there is no existing legal provision, there could be difficulties about any early approach to Congress.

13. As indicated above, the UK also favours Fund borrowing from the capital markets, although other Europeans have - until their recent experience with the Saudi negotiations - been more sceptical.

14. On SDR Matters, the Managing Director does not intend to make firm proposals on further allocations at Libreville. Given US opposition, the time is not ripe. Now will the SDR/Aid Link be raised But at least the allocation issue may come up at Breda. While LDC's are naturally anxious for the unconditional liquidity represented by SDR allocations, it is difficult to meet the criterion in the Articles that new allocations are needed because of a shortage of global liquidity, or to reconcile new allocations with a strong anti-inflationary posture. LDC needs are really best met - whether they like it or not - by IMF lending linked to appropriate adjustment. Further SDR's may be needed in the system eventually. But it may well be better to think in terms of injecting them as part of a properly controlled process whereby they displace dollars and possibly other reserve currencies. Since the SDR was conceived in an era of fixed exchange rates specifically to meet a shortfall of global liquidity and reserves, and since circumstances have greatly changed, much more thinking ought to be done on its future role.

15. On Food (strictly cereals) Import Financing, a consensus is emerging on incorporating some means of compensatory lending for exceptional food import costs within the Fund's existing facility for compensating shortfalls in commodity exports. The French and some LDC's still hanker after a separate scheme, but we are

hopeful that a compromise can be found before Gabon.

16. On the Subsidy Account, there may be a quick tour de table on the willingness of members to make voluntary donations or loans to the Subsidy Account, which subsidises the interest paid by poorer LDC's on their market-related borrowings from the Fund. We, and the US, have consistently said they are unable to subscribe (the funds would have to come from the Aid Programme). The Germans now say the same. The French, and Danes would lend provided several other EC members did. The Dutch and Belgians would subscribe without conditions. Our aid budget is already more heavily committed to multilateral expenditure for several years ahead than we would wish, and its decline in real terms rules out any prospect that the position will improve in 1982 and 1983.

17. The PLO. Not expected to be an issue at Gabon, but may arise in the margins. The current position is that the US-inspired resolution last September is still in force. This froze attendance to those observers who had attended the 1979 Annual Meetings until such time as the Board of Governors had agreed what the procedure on inviting observers should be in the future. Since then there has been some further sterile wrangling in the Fund and Bank and a growing recognition that the issue will have to be settled at a political level between Saudi Arabia and the US before the question of invitations to the 1981 meetings comes up in June. Although the PLO as a political body is unsuited in our view to be an Observer alongside international economic entities, we accept that if the Arabs press for their attendance the US are unlikely to drum up enough support to keep them out. But it is obviously crucial not to alienate the US from the Fund.

BRIEF No 13.

CONFIDENTIAL

CHANCELLOR

cc Mrs Hedley Miller
Mr Atkinson

SAUDI QUOTA INCREASE

I think you may like to see the attached report from Mr Price in Washington of recriminations between the Americans and the French over what happened about the Saudi quota increase. I suppose you might hear something of this topic in Breda, but more particularly there is a suggestion that the Americans intend to complain about the French at the G5 meeting under your chairmanship on 12 April.

2. I imagine that you will not want to preside over an unseemly inquest on that occasion. I think the better approach would be to turn the discussion towards what we do for the future, which includes both the question of IMF borrowing from the market and future relations with the Saudis on IMF matters.

KEC

K E COUZENS
2 April 1981

No. 13

CONFIDENTIAL

2. Mr Allan (G.G.G. Corefine) MT 1/4

## United Kingdom Treasury and Supply Delegation

British Embassy Washington DC 20008
Telephone (202) 462-1340
Telex Domestic USA 89-2370/89-2384
Telex International 64224(WUI)/248308(RCA)/440015(ITT)

Mrs. M.E. Hedley-Miller
HM Treasury
London, England

Your reference

Our reference

Date March 27, 1981

Recd 1 April

Dear Mary,

SAUDI QUOTA INCREASE

1. The Board has just completed its work on the question of the Saudi quota increase, and you should by now have seen a telegram reporting on the last stages. I am writing to tell you separately what passed at a meeting of G5 Directors which Mentré called immediately before the Committee and Board Meetings this morning.

2. The purpose of the meeting was to ensure that the five of us were fully conversant with the agreement, such as it was, which had been reached between the United States and Saudi Arabia. I am sure you already know much of the events of the last few days. The only new fact to me was that there had been a considerable delay on Wednesday and Thursday before Regan managed to speak to Abalkhail. When Abalkhail had failed to return Regan's telephone calls for nearly 24 hours Svyrud had contacted Jalal to ask what the problem was. Jalal had explained that Abalkhail had left Riyadh for three days for a short holiday. Syvrud, on his own account, had then told Jalal in no uncertain terms that if Abalkhail was unable to return Regan's telephone call very soon, there would be no agreement on a quota increase. After that, it was only an hour before Regan received a call from Abalkhail. Of course, as you know, the result of Abalkhail's telephone call was not very productive from our point of view.

3. After we had had some discussion about the order in which we would speak at the Committee and Board meetings, and on what Jalal was expected to say, Mentré concluded that we could be satisfied that the whole episode had been completed in a satisfactory and professional manner. This was too much for Syvrud, who said that it might have been completed much more satisfactorily if some unhelpful comments had not come from the Elysée at a critical stage. Mentré apologised that he could not be responsible for everything said from the Elysée, and he claimed that any such comments had also been made without the approval or knowledge of Monory. Syvrud was not prepared to forget Monory's part in the affair, and suggested to Mentré that Monory himself had made unhelpful comments. Mentré did not, of course, concede that point, but claimed that Monory

/had taken

CONFIDENTIAL

25/4

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had taken at its face value a comment made by Sprinkel when Monory was visiting Washington. When Sprinkel had said that the size of the quota increase was a preoccupation of the Europeans rather than the United States, Monory had understood that the US did not care how large the quota increase might be. Syvrud denied that any US official had ever said any such thing, and said that Monory's remarks, conveyed by the Managing Director to the Saudis, had raised the expectations of the Saudis as to the size of the quota increase.

4. Afterwards, Syvrud told me that the US felt very strongly that the French had pulled the rug out from under the G5's feet and that they intend to raise this matter again elsewhere--by which I took him to mean in London next month. I told Syvrud that we had had a similar problem insofar as the Saudis appear to have been very surprised when I said in the Committee last Wednesday that we would support a quota increase of SDR 1850 million. Apart from indicating to some G5 colleagues a possible fall-back position of SDR 1917 million, we had never indicated that we were prepared to go beyond SDR 1850 million. It is perhaps significant that Jalal did not lobby us for support during the last two or three weeks as he did some other Executive Directors. He seems mistakenly to have taken our silence in the earlier Committee Meetings as indicating that we would support the full request.

5. I am copying this letter to Ron Gilchrist.

Yours ever,

Lionel

Lionel Price

cc: Mr. R.H. Gilchrist (B of E)

BRIEF No. 14 84

CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary
M/State (C)
Sir D Wass
Sir K Couzens
Mrs Hedley-Miller
Mr Ashford
Mr Scholes
Mr Cropper

EXTRAVAGANCE OF THE EUROPEAN PARLIAMENT

1. Your briefing for Breda includes a speaking note on Commission salaries in case you wanted to lobby your colleagues on that subject.

2. Another area of Community extravagance that troubles us is the European Parliament. Mr Ashford has just drawn to my attention a remarkable Motion for a Resolution on this subject put down by two members of the Italian Radical Party. The text is attached. I thought you might like to include it in your papers for Breda in case the opportunity also arose of expressing concern about this aspect of Community expenditure. One can only hope that Mr Pannella and Mrs Bonino succeed in their object of setting up a Committee of Enquiry.

D.H.

D J S HANCOCK
2 April 1981

No. 14

Mr DONOVAN IG2

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European Communities

# EUROPEAN PARLIAMENT

# Working Documents

1981 - 1982

11 MARCH 1981 DOCUMENT 1-16/81

MOTION FOR A RESOLUTION

tabled by Mr PANNELLA and Mrs BONINO

pursuant to Rule 25 of the Rules of Procedure

on the need for sound financial management (Article 206a of the EEC Treaty) of the expenditure of the European Parliament

Mr. Ashford

You will be interested to see this rather forthright draft Resolution. I hope it is adopted!

J E Donovan

English Edition

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The European Parliament,

Whereas:

(1) The EP spends more than 500 million Bfrs each year for rent in the places of work, not to mention the considerable expenditure on maintenance which is often carried out by sub-contractors.

(2) The EP has recently signed a 25-year lease to rent a single information office in London at a cost of 10,230,000 Bfrs per annum. In Paris the rent for the same purpose is 6,766,500 Bfrs per annum. (In Rome the EP Information Office costs about 306,500 Bfrs per annum).

(3) In 1981 the EP proposes to spend about 15,700,000 Bfrs simply for entertainment and ancilliary expenses.

(4) Although the EP has 35 cars which are continually replaced, the 1981 budget provides for the purchase of a further 16 cars and, in addition, 18 million Bfrs are provided for the hire of cars in the places of work of the EP.

(5) During the last few months of 1980 - despite the astronomical sums paid in rent - the EP used rooms in the major hotels in Brussels, paying for these rooms up to 300,000 Bfrs for a few hours, not to mention the entertainment expenses, which were commensurate with the costs of the rooms.

(6) The EP spent more than 18 million Bfrs for its delegation, chaired by Mrs VEIL, to Latin America. This is all the more outrageous if it is considered that the EP budget for 1981 provided for 356,000 ECU = 14,700,000 Bfrs for the activities of a dozen delegations, which makes it perfectly reasonable to suspect that illicit budgetary practices are being used in the EP.

(7) The EP spends enormous sums for the meeting of the European Parliament delegation under the ACP/EEC Agreement. If this meeting takes place in Africa all the European Members take part (60 or 120 depending on whether it is the Committee or the Assembly) with their spouses and other persons, whereas for meetings in the European places of work there are not more than 10 or 15 Members present. In undertaking this particular form of parliamentary tourism, and bearing in mind that the subject of the meetings is under-development and hunger in the world, 'substitutes' can take the place of Members who are unable to attend, in violation of the ACP/EEC rules.

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(8) Certain political group chairmen managed to cover 100,000 km per year (more than 270 km per day for 365 days) with cars and drivers provided by the EP, which cost about 2,200,000 Bfrs per car and per annum.

(9) The principal political groups have the habit of arranging official meetings as though they were tourist excursions. These meetings are paid for by the EP. For instance, the Liberal Group will soon be travelling in full force to Martinique and the Christian Democratic Group has held meetings in Cologne, Palermo and Taormina over a period of two weeks.

(10) All the furniture of the EP is renewed every five years and sold for negligible amounts without any public procedure. Often nearly new furniture and machines which are in good condition are sold in this way.

(11) The pay and all the allowances of Members - which are regulated in a complex and obscure fashion - are open to the same criticisms which have applied for some time to other areas of the financial management of the EP; by means of a complex series of payments, each Member can receive about 3 million Bfrs per annum in addition to his national salary.

- whereas the procedures and time available to the Committee on Budgetary Control prevent it acting quickly and since it is necessary and desirable to set up a parliamentary body which can examine the criteria and the reasons which have led to a situation which is critical for the image and operation of Parliament itself, and can verify quickly and specifically the conditions under which expenditure is committed, paid out, audited and regulated;

1. Decides to set up a committee of enquiry to undertake the tasks set out in the present resolution and consisting of a member of each political group and two representatives of the non-attached Members.

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