Part. A

Begins: 13/7/81.
Ends: 16/7/81.

PO -CH /GH/0083

PART A

Chancellor's (Howe) Papers.

VISIT OF EUROPEAN
JOURNALISTS JUNE 1981

Disposal Directions: 25 Years

D Anderson

26/7/95.

PART A

(formerly ES 116/117/04)

MR SPRINGTHORPE

cc PS/Chancellor
Mr Cardona

Contributors:

Mr Allen EB
Mr Williams EB
Mr Waghorn FP1
Mr Lennon HF3
Mr Thornton PE1
Mr Donnelly PE3
Mr Scholes IG2
Mr Culpin IG2
Mr Atkinson IG3
Miss Leahy IG3
Mr Powell MP1
Mr Haache MP2
Mr Owen EF1
Mr Reed IA1
Mr Mortimer IP1
Mr Andren IP1
Mr Burr IP2
Mr Ramell IP2
Mr White SS1
Mr Corcoran GEP1
Mr Walters GEP2
Mr Carter GEA1

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 6 July version are side-lined.

2. These notes are also being circulated, as usual, to Mr Nield and Mr Eland 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.

M M Deyes

M M DEYES

RA

R I G ALLEN
13 July 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 and better incentives. Budget judgement involved higher overall taxation but the Budget also took steps to redress imbalance between non-oil industrial sector and rest of private sector and provide wider opportunities for enterprise, particularly new and small businesses.

2. Reducing inflation

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 the fight against inflation is key to recovery.

3. When will upturn in economy come?

There are growing signs that the fall in output may have come to an end, and business prospects (witness latest CBI and FT surveys) are now much more favourable. Prospects for next 12 months and beyond depend on many factors, above all further success in reducing inflation and improving industrial competitiveness. [See also Section B].

4. OECD Economic Outlook critical of Government policy?

OECD report broadly endorsed the Government's strategy, and expected some improvement in the UK economy over the next year or so.

5. Government should be reducing taxes/increasing public spending to give a boost?

[Mr Foot's speech 4 July.]

More spending and/or tax cuts have to be financed. Proposals of Rt hon Gentleman the Leader of Opposition could add as much as £6½ billion to PSBR, and disregard the implications for interest rates or (if interest rates assumed to be unaffected) for the money supply and inflation. Lower taxes are of course desirable but can only be achieved within a sound financial framework.

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

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. But tripartite body to be set up to study nationalised industries financing, following NEDC discussion.

[See also Questions E10, E13, and R6-7.]

7. Monetarism has failed?

[D Blake in The Times 13 July.]

Already signs of success. Inflation rate has been reduced. Mr Blake right to say control of money supply not alone enough to revive economic performance. Government has always argued that key to this lies in improving productivity and competitiveness.

8. Unemployment increasing?

Immediate prospects are for unemployment to go on rising for some time yet, but the rate of increase has been slowing down since end of last year. The prospects further ahead depend crucially on securing further reductions in pay settlements so that declining UK competitiveness can be reversed.

9. Government should have done more for industry?

Government has done a good deal eg brought down interest rates, reform of stock relief scheme, incentive packages for small business; flexibility shown in latest concessions on Business Start-up Scheme. Best help Government can give is further progress in bringing down inflation.

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

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

11. Government policy on pay

If decline in competitiveness to be tackled, we must achieve further reductions in pay settlements in the coming payround. Not question of depressing incomes; there have been

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appreciable gains in real personal disposable incomes of individuals - unlike industrial companies -in recent years.

12. The supply side

Companies are tackling problems ignored for far too long. Unreasonable to expect problems to be solved overnight. But there is now growing evidence of improvements in productivity and competitiveness. Productivity (output per employee) rose by about 1½ per cent in production and manufacturing industries in Q1 1981. Estimates by Bank of England and NIESR suggest that output per manhour held up wall in the recession, perhaps increasing between first quarters of 1980 and 1981.

13. UK Government's priorities not in harmony with other countries?

There is no conflict between reducing inflation and increasing employment. Communique from the recent OECD ministerial meeting stated: "Bringing down inflation and inflationary expectations is the indispensable condition for reestablishing the basis for durable increases in employment and more vigorous sustainable growth." It is true that some countries argued in their own circumstances for short term measures to stimulate activity. But most major countries agreed that measures undertaken now to reflate demand would risk undoing the progress achieved so far.

14. US Government's policies damaging interests of others? UK view?

We fully support the thrust of US counter-inflation policy. Vital that US succeeds in bringing inflation down. Tight monetary and fiscal policy should complement each other so as to avoid excessive pressure on interest rates.

15. French Government following better way?

Recent French measures will increase public spending, State control of industry and the Budget deficit. Our policy is to reduce public spending, State control and the borrowing requirement. The fiscal measures in the March Budget enabled a reduction in interest rates.

B. ECONOMIC ACTIVITY AND PROSPECTS

[Latest information:

GDP fell ½ per cent in first quarter 1981. Underlying levels of industrial production and manufacturing output remained broadly flat over first five months of 1981. Consumers' expenditure in first quarter 1981 rose 1½ per cent. Retail sales in first five months 1981 about 2½ per cent up on 1980 average. Real personal disposable income fell 1½ per cent in first quarter 1981; but still 15 per cent up on average level in 1977. Savings ratio fell to about 14 per cent in first quarter, (compared with peak of 17 per cent 1980 Q3). Export volume (excluding erratics) fell 1 per cent in three months to February 1981. Import volume (excluding erratics) fell 1½ per cent over the same period. Current account almost certainly exceeded £2 billion in first quarter 1981. Manufacturers' capital expenditure fell 3½ per cent in first quarter 1981. Capital expenditure by distributive and service industries (excluding shipping) fell 3 per cent. Fall in stocks moderated slightly in first quarter 1981. May Department of Industry investment intentions survey suggests further falls in investment in 1981 with some recovery between 1981 and 1982. Latest (June) CBI inquiry shows little change in manufacturing output expected in next four months. FT survey published 6 July shows further improvements in business confidence and new orders.]

1. Latest output and production information

[May figures show fall of 1 per cent for manufacturing and ¾ per cent fall in all industries index - essentially due to disputes at BL and Ford's.]

Too much should not be read into one month's figures. Allowing for BL and Ford strikes, figures continue to show a levelling out of industrial output since end of last year.

2. Signs that trough of recession being reached?

Many indicators suggest that the economy is at or close to the bottom of the recession. In particular, stabilisation of industrial output, slowdown in rate of decline of GDP, business opinion surveys (CBI, and FT), CSO leading indicators, labour market indicators, and pattern of outside forecasts. All consistent with Treasury's forecasts published with Budget.

IF PRESSED: Evidence not conclusive? Prediction and measurement cannot be exact. Nobody knows precisely when recovery will begin. Equally pointless to ignore indications that recession is bottoming out. Surely this is to be welcomed by all.

IF PRESSED: Where will recovery come from? In the main from the reversal of the same factors that contributed to the fall in output; the slowing of destocking, a fall in the savings ratio (as inflation is lower) and some recovery in world trade.

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]

Budget forecast assessment suggested beginnings of recovery in 1981 H2 and possibly single figure inflation possibly by around the turn of the year.

4. OECD expect no recovery in output, and double-figure inflation, until 1982?

[OECD published latest forecast 10 July. Fall in UK output expected to end in Q4 1981, followed by modest recovery in 1982. (Year on year GDP changes - 1½ per cent 1981, ¾ per cent 1982.) Inflation to fall gradually to 8½ per cent by end 1982. NB Projections were made before June-July falls in sterling.]

OECD views basically consistent with FSBR forecast in expecting some recovery in output, and single figure inflation in 1982.

5. Most outside forecasts show output falling throughout 1981; suggest no recovery before 1982 at earliest?

[Fall in GDP expected in range 1½ per cent (LBS, NIESR) to 3½ per cent (CEPG). Most forecasters see worst of output fall over; Phillips and Drew, LBS see some upturn in remainder of year; St James Group see almost continuous rise in output from 1982; CBI and OECD see weak recovery from start 1982; NIESR see no real change in output to end 1982. CEPG and ITEM see continuous fall in output to 1983 and beyond. Consensus that year-on-year inflation rate in Q4 1981 will be above 10 per cent. All forecast current account surplus ranging from £1 billion (Cambridge Econometrics) to over £5 billion (NIESR, ITEM). Unemployment (UK, narrow definition) is generally expected to exceed 2¾ million by end-year.]

Must expect difference of views among outside forecasters (e.g they use different economic models; make different assumptions about key policy and exogenous variables etc). Both Phillips & Drew and LBS show output rising in 1981. CEPG have dismal recent record in forecasting output movements. Of course all forecasts are subject to wide margins or error.

6. Recession worse than in the 1930s?

Any such comparisons must of course be subject to a statistical health warning. It is true that the fall in manufacturing output is comparable to the 1930s, but structure of the economy is much changed. Fall in GDP is less than in 1930s.

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C LABOUR MARKET

[Latest information: registered unemployed (UK seasonally adjusted, excluding school leavers) rose in June to 2,552,000 (10.6 per cent). This is a rise of 1,295,000 since August 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 83,000 in June and remain very depressed. Manufacturing employment (GB) fell by average 50,000 per month in four months to April, compared with 77,000 per month in second half 1980. Total employment estimated to have fallen by around 1.4 million since mid-1979.

1. Unemployment will continue rising?

See A8.

2. July figures will show 3 million unemployed?

[Next unemployment Press Notice to be published 21 July. Press Notice published 10 July warned that civil service dispute would artificially raise July count by "a substantial amount" (reported in Press as 100,000). This, plus usually large seasonal rise between June and July, plus perhaps 100,000 extra school leavers on register, plus underlying rise in adult unemployment, could well push "headline" total from 2-7 to near 3 million.]

July figures will be artificially raised by the emergency procedures made necessary at unemployment benefit offices by the civil service dispute. This should not cloud the fact that the underlying rate of increase in adult unemployment is on a sharply downward path in 1981.

3. New employment measures on the way?

We are conducting a review of the special employment measures, and considering a number of options. An announcement will be made in due course.

4. Mr Roy Jenkins has suggested £6 billion programme to get 1 million off register in 2 years?

Not seen detailed calculation to back up this estimate. But would seem to involve very optimistic assumptions about the effect of employment subsidies. Where would the £6 billion come from? We are of course already operating special employment measures where cost-effective to do so.

5. Would work-sharing help reduce unemployment?

I doubt whether this is the answer. We prefer to leave the determination of hours and working schedules to the decision of employers and workers who know the local conditions. But unless people prepared to accept reduction in income commensurate until reduction in hours effect on productivity and competitiveness likely to make worksharing counter productive.

6. 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 contained estimate by Treasury that, for 1980-81, an additional 100,000 unemployment in private sector means direct Exchequer cost of £340 million. But this figure cannot be naively grossed up to estimate cost of all those currently unemployed.

7. 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 Exchequer. Unlikely to attract people to take work. If wages more generous, there would be net cost to Exchequer and 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.

8. What is Government doing to provide more jobs?

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

9. OECD gloomy on prospects for unemployment, especially among young people?

[OECD forecast published 10 July shows total unemployment in UK - including school leavers - perhaps exceeding 3 million by end 1982, and youth unemployment rates in 1982 perhaps over 20 per cent in UK, France and Italy.]

Unemployment forecasts inevitably very uncertain, particularly those for specific groups within the total. Outside forecasters use different models, make different assumptions and show wide range of possible outcomes for 1982. YOP doing much to help young people.

10. 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. Governemnt Actuary's Report published 3 July revised 1981-82 assumption to 2.6 million. Most outside forecasters foresee around 2¾ million (UK, narrow definition) by Q4 1981; NIESR, Phillips & Drew, OECD and ITEM see a further rise to

around 3 million by end 1982; Cambridge Econometrics see level well above 3 million throughout 1980s. CEPG forecast about 4½ million by 1985. LBS see unemployment levelling out at around 2¾ million from 1982.]

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. Outside forecasters show wide range of possible outcomes, particularly for 1982 and later years.

11. Reasons for increase in unemployment?

Part of reason the effect of world recession, which has meant increased unemployment in virtually all countries. But made worse in UK by past failure to adapt to changing conditions and opportunities, and by increases in earnings unmatched by productivity. Biggest threat to employment comes from excessive wage awards. But encouraging signs that pay negotiators are acting more realistically.

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

Unemployment statistics are published on the same basis as under previous administration. MSC has wisely commented (in paper to NEDC) "the current definition provides a good and well understood series for discerning trends and once that firm ground is left, there is endless scope for statistical and semantic debate." We are concerned about unemployment however defined. But our policies are laying foundation for creation of secure employment.

13. Unemployment as bad as in the 1930s?

Comparisons extremely difficult to make. Maximum recorded unemployment in 1930s was just under 3 million; but the labour force has grown by about 1/3 since, so unemployment rates in the 1930s higher than now. One also needs to bear in mind changed social conditions and protection given by the welfare state.

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

Unemployment been on rising trend for some time. Regrettably, 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].

D TAXATION

GENERAL

[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]

1. Burden of taxation

Inevitably increased during a time when national production has not been growing. But, for the vast majority, real personal disposable income is substantially higher than when the Labour Party was in Government.

2. Government policy regressive?

Largest percentage reductions in take-home pay, as a result of March Budget, were for 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. Real take-home pay still higher now than before Government came to power.

4. Government policy has harmed incentives?

Marginal rates of income tax for most taxpayers lower than when the Government came to power. Basic rate not increased in March Budget.

INCOME TAX

5. Wrong not to index personal allowances in March Budget?

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.

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

Widows and single women aged between 60 and 65 on National Insurance basic retirement pension alone will not pay tax. [IF PRESSED: Regrettably true that some additional women of this age with other income besides basic pension will pay tax this year, but numbers should not be exaggerated.]

INDIRECT TAXES

7. Indirect tax increases inflationary?

True that the indirect tax increases have added some 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.

8. 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.

9. Heavy fuel oil duty

Costs involved mean that it would not be in the national interest to go beyond the Budget decision not to increase the duty in heavy fuel oil. Terms of North Sea gas contracts a commercial matter for the British Gas Corporation.

10. Derv reduction

Halving of Budget increase in tax on derv to 10p a gallon implemented on 2 July rather than after Royal Assent. Early implementations will give commercial road users the benefit at earliest possible date. Real value of derv duty now about 60 per cent of 1970 level.

11. Tobacco and betting increases

Recoupment of cost of derv reduction (£85m in current year) by increases on tobacco and betting are essential part of strategy for reducing the PSBR and thus containing inflation. Not unreasonable to ask smokers to pay more. In real terms duty burden on typical packet of 20 cigarettes remains will below level of some recent years (ie 1974 and 1975). Much of post-budget short-time working in industry resulted from heavy pre-Budget forestalling.

INDUSTRY AND BANKS

12. 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.

13. Progress with examining corporations tax structure?

[Promise to re-examine corporation tax structure in 1980 Budget Speech]

It is hoped to produce the Green Paper on corporation tax this winter.

14. Business start-up scheme

Scheme will make major contribution to financing of new business start-ups. Government has made a number of amendments which have extended the relief in certain important respects. I am convinced that the scheme is now an even surer winner.

15. Special tax on banking deposits: unfair?

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.

16. Special tax on banking deposits: concessions

The increased threshold and reduced rate band announced by the FST on 25 June provides help where most needed, eg the smaller banks, at a cost of about £25 million.

17. Special tax on banking deposits: retrospective?

Not done without warning. My rhF the Chancellor had explained in 1980 Budget there could be a case in principle for a special tax and he would be considering this further.

E PUBLIC EXPENDITURE AND FINANCE

1981 SURVEY GUIDELINES

[Accurate report by Goodman and Riddell published in Financial Times 14 May. Main features of guidelines are: 1981 Survey will be conducted in cash using factors of 7 per cent for movement in prices between 1981-82 and 1982-83 and 6 per cent and 5 per cent for two following years; options for reductions are asked for amounting to 3 per cent and 5 per cent in 1982-83 and 5 per cent and 7½ per cent in each of later years.]

1. Further cuts - a figure in mind?

We have made it clear we consider planned levels of spending too high in relation to our financial and monetary objectives and that in the course of the survey we will give careful consideration to scope for further cuts. Scale and incidence of any reductions will be considered and decided in due time and it would be premature to speculate now about the outcome.

2. Is not Government seeking cuts of 7½/5/3 per cent?

Survey guidelines ask for options for reductions: no proposals at this stage for cuts. Request for options is normal part of Survey procedure, designed simply to allow collection of material needed for discussion.

3. Prime Minister's statement (Nationwide, 14 May) that "we have done almost as much as we can on cutting spending"

Certainly, in short-term, little scope for cutting spending. In medium-term our aim is to get public expenditure down; finding ways of doing this is one purpose of the annual survey.

4. Public spending should be increased, not cut, at a time of recession?

To achieve sustained growth, we must reduce inflation. This requires strict adherence to firm monetary and fiscal policies. Need to reduce public spending to give scope for reductions in taxation.

5. Are Government forecasting 7 per cent inflation over the next 12 months?

[Reference to guidelines for PESC]

No. RPI forecast given at Budget time was for 8 per cent to the 2nd quarter of next calendar year. The 7 per cent figure to be used relates to general costs in public expenditure but is in any case not at this stage intended to be either a forecast or a target; merely a basis for constructing reasonably realistic figures which will then be subject of more detailed discussion when survey material comes to Ministers later in year.

6. 7 per cent a pay norm?

No. Government is not in the business of setting pay norms. The 7 per cent figure applies to all costs, not particularly to pay. Assumptions used at this stage in the survey are not intended to be firm operating numbers, but merely basis for constructing expenditure figures for later discussion. Assumptions will be reviewed in the autumn in the light of developments, including Government's view on pay increases.

GENERAL STRATEGY IN PUBLIC SPENDING

7. Public spending 1981-82 and its implications

Level of spending projected in White Paper (Cmnd 7841) implies tax burden significantly higher than Government would wish. Recession has created pressure to increase spending; this has been taken into account in the plans. But Government is committed to restraining public spending, and will be looking at level of it in forthcoming annual review. This will involve looking at implications for Government's monetary and fiscal policies.

8. Expenditure higher than planned in 1980-81: what will prevent repetition in 1981-82?

Cash expenditure was higher than planned last year. This was due largely to factors to do with the recession. These factors were taken into account when setting totals for 1981-82.

9. Government has failed in its aim to reduce expenditure?

Public expenditure is higher than we would have wished. This is partly an effect of the recession. Even so, public expenditure in 1981-82 will be nearly 5 per cent below volume planned by previous Government. Two thirds of reduction in spending planned in 1980 White Paper has been preserved in spite of strong upward pressure exerted by the recession.

10. Increase capital spending

Need is to reduce total spending. Balance between current and capital spending will be one of points for forthcoming annual review of expenditure. Many of relevant considerations discussed in rhF the CST's speech in debate on Public Expenditure White Paper (9 April 1981).

11. Public spending overwhelmingly on administration?

Not all current expenditure is administration. One third is current payments such as money paid out to pensioners and unemployed, child benefit, etc. One fifth purchase of goods and services, eg for defence. One tenth grants such as overseas aid, and subsidies. Only a third wages and salaries; much of that is for nurses, teachers, policemen, soldiers etc.

12. Cut staff numbers in public services

Numbers in public service have already fallen since we took office. Civil service has been reduced by nearly 6 per cent; we intend to achieve by the end of this Parliament the smallest civil service since the war. Local authority manpower has been reduced by about 50,000.

13. Raise the proportion of public investment within the total?

Government will consider this carefully during forthcoming annual survey. But not clear that the case has been adequately made out. Priorities must be decided primarily in terms of services - to which current spending may be no less important than capital.

14. What is the point of cash planning?

Government must plan in relation to availability of finance as well as to prospective resources. An illusion to suppose there can be unconditional commitment to forward plans for services.

15. 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.

LOCAL GOVERNMENT

16. Mr Heseltine's Statement of 2 June

Local authority expenditure in England is some 5.3 per cent (November 1980 prices) above Government's expenditure plans. So my rhF the Secretary of State for the Environment is calling for local authorities to revise their budgets. If local authorities collectively fail to reduce their budgets he will impose a cut of £450 million in the RSG at Supplementary Report Stage next autumn (the new form of 1st Increase Order stage under block grant).

17. Effect on public expenditure? Supplementary rates?

Hard to quantify. We hope local authorities will cut expenditure, rather than replace lost grant by supplementary rates. In doing so they will avoid all or part of the reductions in grant which would otherwise be imposed on them.

18. Restoration of £200 million (cut in 1980/81)

Too soon to decide on restoration of the £200 million grant cut in England and Wales last year. A final decision will be taken when next final outturn data is available in the autumn.

19. Rates - medium term? Powers to control rates?

Government is considering the introduction of further measures to bring home to local councils and ratepayers the consequences of extravagant spending policies. These will probably involve legislation. There will be consultation with local authorities in due course.

20. Rates - longer term

There will be a consultation document later this year on alternatives to domestic rates. The problems for finance for local government spending cannot be divorced from the difficulties caused by excessive spending.

21. Scotland - Statement of 4 June

Scottish local authorities are budgeting for expenditure in 1981-82 some 8.8 per cent above the Government's plans. So my rhF the Secretary of State for Scotland is asking for revised budgets. He also intends, if the Local Government (Miscellaneous Provisions) (Scotland) Bill is passed, to cut the rate support grant to those authorities who are still planning to spend excessively. On present plans £100 million would be withheld.

22. 1980-81 possible grant reductions in Scotland?

Need to await final outturn figures. If these disclose excessive spending by local authorities they will incur grant reductions. If outturn is in line with budgets, the reductions will total £60 million.

PUBLIC SERVICE PENSIONS

23. What is happening about public service pensions?

Report of the Committee of Inquiry (under chairmanship of Sir Bernard Scott) into the valuation of public service pensions was published 5 February. Government is still considering the Report but has made it clear that reaction to the Report will be taken into account before any decisions are made.

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F SOCIAL SECURITY

[Government Actuary's report published 3 July shows that for the current financial years the National Insurance Fund have moved from a surplus of £39 million predicted in the previous GA report to a predicted deficit of £619 million. It also shows an increase in the unemployment assumption (from 2.5 million to 2.6 million) and that the income from investment has been reduced from £695 million to £500 million partly because of Civil Service strike action]

1. Does the Government Actuary's prediction of a £619 million deficit this year worsen prospects for the PSBR?

No, a deficit of this scale on the Fund anticipated in the Budget arithmetic.

2. Does this mean NI contributions will rise again next year?

No, a decision on the rate of contributions for 1982-83 will be taken in the light of the further report by the Government Actuary in November and will take account of later assumptions about prospects.

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

No. The 1 per cent abatement in the 1981 uprating will recover the overpayment in the 1980 uprating, and simply ensure that the value of the pension is maintained - but not increased.

4. Does Government intend to ensure that value of pensions will be maintained?

I have given a clear undertaking that over the lifetime of this Government the value of pensions and other long-term benefits will be maintained. This pledge has been reiterated by my rhF the Social Services Secretary.

5. Does PM agree with Chancellor's view that retired are a burden on its working population?

This was not what the Chancellor said. In his speech to the National Association of Pension Funds (7 May) he was drawing attention to the need to consider how the much larger pensions planned for the future were to be financed.

6. When will other short-term benefits be brought into tax?

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

G PUBLIC SECTOR BORROWING

1. PSBR in 1980-81?

[PSBR in 1980-81, published 21 May, was £13¼ billion, £¼ billion lower than estimated at Budget time.]

The PSBR in 1980-81 was £13¼ billion - very close to the assessment made at Budget time.

2. Effect of civil service dispute on CGBR in 1980-81?

In March the civil service dispute resulted in some £¾-1 billion delay in central government revenue. The impact of this on the PSBR was offset by other factors. These factors included lower "supply" expenditure and local authority borrowing than expected in March.

3. Effect of dispute in April - June?

Over ¾ of revenue due has come in. But an estimated £3¼-3¾ billion of revenue was delayed in April, May and June, resulting in a CGBR of £7.4 billion for the three months.

4. Will the government be able to collect all delayed revenue this financial year?

The sooner the strike ends the more likely it is that a large proportion of the revenue will be collected.

5. What is the cost of the strike so far?

The net cost to central government at end of June was about £60-70 million. This is mainly interest on the temporary additional borrowing, less deductions from pay of civil servants on strike after allowing for tax lost on that pay. These costs are not significant compared with the damage to the prospects of a further reduction in inflation if the Government concedes an excessive pay settlement.

6. Are we on target for the £10½ billion forecast in the FSBR?

It is too early to say.

7. Outside forecasters' views of FSBR forecast of £10½ billion PSBR 1981-82?

[Post-Budget forecasts range from £9½ billion (NIESR) to £12¼ billion (ITEM).]

Major outside forecasters, covering wide spectrum of economic opinion, predict PSBR for 1981-82 well within average margin of error of FSBR forecast.

8. Effect of dispute on money supply? MTFS?

At most there will be a short-term increase in the money supply which will subsequently be corrected, and therefore not jeopardise the Medium Term Financial Strategy.

9. Will interest rates rise?

As the increase in the money supply due to the strike is only expected to be temporary, there is no reason why this need lead to higher short-term interest rates.

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

[FSBR forecasts PSBR of £10½ billion, 4½ per cent of GDP. Direct effect of Budget measures reduces PSBR by £3½ 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.

H MONETARY AND FINANCIAL POLICY

[Latest information: £M3 increased by about ½ per cent in banking June. Full figures to be published 16 July].

INTEREST RATES

1. Cut interest rates now

Interest rates have fallen by 5 per cent since last summer, as inflation has fallen and monetary growth moderated. Wrong to allow interest rates to fall too quickly and jeopardise success in bringing down inflation.

2. Surely we should be reducing interest rates?

All of us want to see lower interest rates. Short term interest rates have fallen by 5 per cent to 12 per cent since last summer and UK interest rates are now among the lowest in the industrialised countries. But if interest rates fall too far too quickly they could jeopardise our success in bringing down inflation.

3. Will high interest rates overseas force ours to rise in order to arrest the fall in sterling's value?

The Government does not have a target for the exchange rate. We believe that the exchange rate should be principally determined by market forces. Our intervention is limited to 'smoothing', to moderate excessive fluctuations and preserve orderly markets. Interest rate policy is set in accordance with our domestic monetary objectives.

4. What does the fall in sterling mean for monetary policy?

It can, of course, have some temporary effect on prices but in the long run domestic inflation rate is determined by the rate of growth of the money supply. As long as we continue to restrain monetary growth, inflation should continue to fall.

5. Are the Government not concerned about high US interest rates?

The broad lines of US policy closely parallel our own. We fully support their fight against inflation. An appropriate balance between fiscal and monetary policies should prevent undue pressure in financial markets.

6. Let market set interest rates

Certainly our intention to enable market forces to play a greater role in determining interest rates. My rhF announced in his Budget speech that changes in Bank of England's

market operations are designed to allow this. Discussions on further improvements in monetary control are now well advanced and the Bank has just issued the final draft of the detailed provisions. When these are put into effect we shall aim to keep very short-term interest rates within an unpublished band. It may then be appropriate to suspend or abolish the practice of publishing an MLR.

7. Is strike preventing Government from reducing interest rates?

No. Government will make its best estimate of the underlying position and base its decisions on that, though you will have noticed the Civil Service Unions openly boasting that they have held interest rates up. This gives the lie to their claim that they do not intend to hurt working people.

MONETARY POSITION

8. Why were short-term interest rates increased last week?

I understand that the Bank of England has, through its operations in the money markets, allowed short-term interest rates to move into line with long-term rates. It was decided that it would be sensible in present circumstances not to allow market conditions to become too easy.

9. Is Civil Service strike harming Government's monetary strategy

No. After allowing for distortions caused by the Civil Service strike we estimate that monetary growth is within our target range and we remain on course for meeting our objectives. Position will correct itself. Taxes will eventually be collected. Companies' behaviour will not be significantly altered by a temporary improvement in liquidity: the money is unlikely to be spent. We have always said that month to month movements in the monetary aggregates have limited significance, particularly where the problem, as here, is one of timing.

10. Is not growth in M3 cause for concern?

[David Marsh article in Financial Times 22 June]

This rapid growth in M3 is largely due to the continued increase in UK residents' holdings of foreign currency deposits. Some increase in these holdings was to be expected following the abolition of exchange control. Providing that our exchange market intervention continues to be confined to small scale smoothing operations, an attempt by the private sector to switch these currency balances into sterling will mainly affect the exchange rate rather than M3.

J PRICES

[Latest information

RPI rose 11.7 per cent in 12 months to May. Increase in the index over the month was 0.7 per cent; increase over the last 6 months at annual rate was 14.7 per cent excluding seasonal foods). Tax and Price Index rose 15.3 per cent in 12 months to May. Year-on-year increase in wholesale output prices to June 1981 was 10 per cent - last six months at annual rate 14.3 per cent; the increase in recent months has been due to Budget effects, the usual annual bunching of price increases, and higher priced petroleum products. Wholesale input prices year-on-year increases to June was 14.0 per cent - increase over last six months at annual rate rose to 25.3 per cent, largely due to rises in the sterling price of crude oil.]

1. Further inflation fall unlikely?

[P Riddell in Financial Times 13 July]

In short term, exchange rate depreciation does not help inflation prospect. Over the long run, inflation rate is primarily determined by movements in monetary aggregates.

2. What is Government's inflation forecast?

Government forecast published at Budget time was 10 per cent year on year increase between 4th quarter 1980 and 4th quarter 1981.

3. Budget increased inflation?

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

4. RPI movements?

Year on year increase in RPI has been on a downward trend since May 1980. There was a small blip on this trend in March - 12.6 per cent against 12.5 per cent in February - caused by the timing of the Budget.

5. TPI

[Increase over the twelve months to May was 15.3 per cent, compared with an increase of 11.7 per cent in the RPI. FST said 17 August 1979 'If you want a general guide to changes in the total costs facing taxpayers, look at the TPI, not the RPI']

The higher increase in the TPI reflects the tax measures which have been taken to restrain Government borrowing, which is essential if inflation is to be controlled.

6. <u>But rate of inflation still far higher than when Government took office?</u>

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 11.7 per cent. [Relevant figures are:- year on year rate at May 1979 10.3 per cent - <u>up</u> from 7.4 per cent in June 1978 (immediately previous lowest point); year on year rate at May 1981 (latest available month) 11.7 per cent - <u>down</u> from 21.9 per cent in May 1980].

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K EARNINGS

[Latest information

Year on year increase in the average earnings index fell to 14.0 per cent in April* compared with 14.5 per cent in March. Underlying rate of increase in earnings over the last year is around 14 per cent. Over current pay round average earnings have been rising by average of ¾ per cent per month - compared with double that figure in the earlier part of 1980.]

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 has continued to average between 8 and 9 per cent since last October.

2. Earnings figures belie low settlements?

The figures show that average earnings rose by an underlying rate of ¾ per cent a month between August 1980 (start of current payround) and April 1981 - less than half the average rate in first half of 1980.

3. Comparison of movements in TP1 and earnings index show real take-home pay has fallen over past 12 months

Yes, but this follows a growth of 17½ per cent in personal living standards in three years 1977-80.

4. Next pay round?

The Government is not in the business of setting pay norms - either in the public or the private sector. Important that in the next pay round settlements generally should be a lot lower than in the past 12 months. What Government wants are settlements that help to reduce costs and improve competitiveness -and, in the public services, that the taxpayer can afford. Low pay settlements are essential if we are to see growth in output and employment.

5. Government would like to see 5 per cent average increase - or less?

Government is not in the business of telling industry what to pay. What we are saying is that settlements in general need to be a lot lower.

6. Public spending review guidelines indicate 7 per cent pay norm in next pay round for public servants?

No. The 7 per cent figure for 1982-83 is a working assumption to construct cash figures for the 1981 public expenditure survey. It applies to all costs, not particularly to pay, and will be reviewed in the autumn.

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* Average earningsindex for May to be published Wednesday 15 July.

7. 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. The figure of 6 per cent in the Public Expenditure White Paper is a provisional working assumption. Whatever figure is finally decided will not be a limit on settlement levels but on the pay bill.

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

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

9. 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.

L BALANCE OF PAYMENTS

[Latest information

Current account: Full data for March are not available but the current account in first quarter 1981 was without doubt in strong surplus (almost certainly in excess of £2 billion). Capital account figures showed outflow of £2.5 billion in first quarter 1981.]

1. No recent trade figures

[No new trade figures since those for February.]

Publication of trade figures has been delayed as a result of industrial action by those normally involved in collating the data.

2. Latest available trade figures?

It is not possible to estimate visible trade figures for March. However, given the large visible trade surpluses for January and February, and the estimated £1 billion invisibles surplus for the quarter, it is clear that the current account as a whole was in strong surplus over the first quarter.

3. Main features of figures for balance of payments in Q1 1981?

The surplus on invisibles rose by about £300 million from fourth quarter 1980 to reach almost £1 billion in first quarter 1981. (A large part of this increase stems from refunds from the European Community.) On the capital account, the £2.5 billion outflow is the largest even recorded. (It results from continued high level of portfolio investment overseas and of sterling lending overseas by UK banks together with a turnaround in UK banks foreign currency lending and borrowing).

4. Overseas flows a drain on the economy?

Outflows on the capital account are the necessary counterparts to our recent healthy current account surpluses. They represent acquisitions of assets which will provide valuable income from abroad in the future and, insofar as they involve sales of sterling, they also can relieve upward pressure on the exchange rate.

5. Selective import controls?

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

Sterling strengthened briefly on rising domestic interest rates, but fell back as the dollar remained firm. The markets continued to be highly volatile. Closing rate against the dollar on 10 July was $1.8965 - little changed from previous Friday - with an effective rate of 93.31. Lowest recent rate was $1.8685 on 9 July in New York. Earlier lows: $1.91 (5 June - falling oil prices and high US interest rates); $2.09½ (25 October 1979 - abolition of exchange controls). Highest recent rate was $2.4565 (4 November 1980). Reserves at end-June stood at $25.63 billion, compared with $26.49 billion at end May.]

1. Recent fall in sterling

It is important to keep the recent fall in perspective. In April/May the pound fell slightly against the dollar but rose against the continental currencies. In early June there was a reassessment of sterling by the markets (perhaps triggered by falling oil prices) and sterling followed the Continental currencies in falling further against the dollar as a result of high US interest rates. Recent developments have not reflected the weakness of sterling, but the strength of the dollar which has risen sharply against all currencies. Since the autumn, sterling has fallen by about 21 per cent against the dollar (to its lowest level since July 1978) but has risen by around 4 per cent against the Continential currencies.

2. Has the Bank intervened to support the rate?

Whether the rate is rising or falling, the Government's policy is to allow it to be determined primarily by the balance of market forces. Recently the Bank has intervened in a modest way from time to time - in line with policy - to steady the rate when it came under sharp downward pressure, and to preserve orderly markets.

3. U-turn on exchange rate policy?

[Sunday Times article 5.7.81]

There is really nothing new to say. Our policy is unchanged. The exchange rate is determined principally by market forces, and the Government has no target rate for sterling.

4. At what level of the pound will Government take further measures?

A hypothetical question. Government does not have a target for the exchange rate.

5. Exchange rate and competitiveness

The fall in the pound will bring benefits in terms of stimulating exports and disadvantages in

terms of higher costs for imported materials. I share Sir Terence Beckett's view that the benefits should outweigh the disadvantages and improve prospects for British industry. But fundamental improvement in competitiveness will only be achieved if we can control costs, improve the quality of our products and ensure that wage rises are matched by increased productivity.

6. Inflationary impact of sterling's fall?

Recent fluctuations in rate will have some temporary effect, but in the long run domestic inflation rate is determined by rate of growth of money supply. Account must also be taken of the fact that although the dollar rate has fallen, the effective rate has risen by about 8 per cent since the Government took office. It is therefore misleading to focus on short-run deviations from long-term relationship between prices and money supply. [Exchange rate and interest rates covered in Section H. See also J1].

6. Debt repayments

It is the Government's intention to reduce the burden of external debt substantially during this Parliament. We intend to prepay this year the $2.5 billion Eurodollar loan, $1.7 billion of which was repaid in May, and to continue with other scheduled repayments.. By end of 1981, total official external debt will be reduced to around $14 billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

EUROPEAN COMMUNITY

1. Cost to UK of membership too high?

Costs and benefits of UK membership of the Community must be viewed as a whole. We realise the need for reform of the Community financing as well as my hon Friend/the hon Member. We have already achieved a major reduction in our net contribution through the agreement reached on 30 May 1980. We shall continue to press for reform of the common agricultural policy (CAP) and restructuring of the Community Budget.

2. Net contribution too high?

A lot lower than it would have been without the agreement of 30 May last year. Important to build on that as soon as possible.

3. Government views on European Commission's restructuring report?

Glad that the report has now been published. We shall naturally be studying it carefully to see how it measures up to the problems faced by the Community, as set out in my rhF's Hague speech on 3 June, and in particular whether it provides for a Community solution.

4. Effects of Commission's proposals on UK?

The report contains no figures. The effects on the UK would depend critically on the detailed execution of the Commission's suggestions.

5. Handling of Commission report

The UK presidency will be arranging for the Commission's ideas to be discussed intensively in the early autumn so that the Community can take the necessary decisions at the end of November.

6. Policy for CAP reform

Greater attention must be paid to the needs of the market, and action taken to curb surplus production and contain the growth of guarantee expenditure. Will continue to press for price restraint and other measures appropriate to surplus sectors.

7. Costs of CAP to UK consumers

My rhF, the Minister of Agriculture, has dealt with a number of questions on this. Costs to consumers of the CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to a reduction in the cost of food to the consumer could well involve increased costs to taxpayers.

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

Our position is that there will not be an increase in the 1 per cent VAT ceiling, and discussions on the restructuring of the budget and other matters are within that firm context.

EUROPEAN MONETARY SYSTEM

9. 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) rose 3¼ per cent over 6 months to March 1981 compared with previous six months. Profits of non-oil companies (on same basis) fell 3¾ per cent over same period. Financial deficit and borrowing requirement of industrial and commercial companies fell sharply between first and second halves of 1980. Bank borrowing (by ICCs) also fell sharply. Company liquidity (DOI quarterly survey) for manufacturing companies fell slightly in Q1 1981, but deteriorated markedly for non-manufacturing companies. Overall liquidity ratio 1981 Q1 similar to first three quarters of 1980. Company liquidations (seasonally adjusted) in first quarter 1981 were running 25 per cent higher than in fourth quarter 1980, although underlying level in April showed first significant fall for over a year. Industrial and manufacturing production broadly flat in first five months of 1981. Stocks held by manufacturers, wholesalers and retailers fell by £½ billion in first quarter 1981, compared with a fall of over £¾ billion in the fourth quarter 1980. Employment in production industries fell by 900,000 in the 12 months to April 1981.]

1. Budget did 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. Two 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.

2. A more positive industrial policy?

While not ruling out constructive intervention at the margin, particularly in areas of high technology, we believe one of the main reasons for our poor industrial performance has been that the 'invisible hand' of the market place has too often been obstructed by the very visible hand of bureaucracy. Unlike our predecessors we are not in the business of "picking winners" and we reject all suggestions that the Government should adopt an industrial policy/strategy of this kind.

3. Present policies inimical to investment?

Industrial investment has held up relatively well in comparison with the fall in output over past 2 years. Indeed investment in plant and machinery during the recession was almost 5 per cent higher than in 1979, which in turn was 7 per cent up on 1978. That is after adjusting for inflation.

4. Government help for small firms

[Comprehensive account of steps taken to assist small firms in all three of Government's Budgets and in other ways set out in Economic Progress Report April issue published 15 April.]

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 launched on 1 June. These measures - and the others which my rhF also announced in his Budget statement - are aimed at encouraging enterprise and risk-taking. [See also D14]

5. Response to Loan Guarantee Scheme?

Very substantial interest already shown in scheme. During first month of its operation, 65 guarantees have been issued under the scheme - 38 of which are for loans for new businesses. Total amount of loans for which guarantees issued is nearly £2½ million. Believe scheme will play significant part in encouraging enterprise of small firms sector.

ENTERPRISE ZONES

6. Progress with setting up Enterprise Zones?

Very good progress being made. Enterprise zones at Swansea, Corby and Dudley are already in operation and we expect most of the other zones to become effective during August.

7. Designate enterprise zones at Chatham and/or Portsmouth (given dockyard closures)?

We do not think it would be appropriate to consider designating further zones for the time being, beyond the eleven we have announced. We need to allow time to see how things develop in these 11 zones.

CASHLESS PAY

8. Cashless payment of wages: Government consider legislating on Truck Acts?

[CPRS discussion document published 15 June indicates that CPRS see Truck Acts as one obstacle to cashless pay, but not an over-riding one].

Government believes there are a number of advantages in employees receiving pay through banks etc., and monthly rather than weekly. Invites responses to CPRS document.

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 South East England, the Inner London Postal Service, British Gas retail showrooms, the Central Electricity Generating Board, and the Severn-Trent Water Authority.

2. Progress with 'privatisation'?

Privatisation is not as simple as it appears to some of its armchair advocates. Simply not possible for Government to privatise any and every publicly owned industry at stroke of a pen. Biggest disposal so far has been the sale of BP shares. British Aerospace has been successfully transformed into a private sector company. We shall be bringing in legislation next session to separate out the oil exploration and production business of BNOC so as to permit introduction of private equity. Also in the oil sector, we have already raised some £210 million by selling certain North Sea oil licences. In addition there have been a number of smaller steps including sale of motorway service areas, disposal of major NEB shareholdings in Ferranti, sale of shares in the Suez Finance Company, the beginning of sales of BR hotels. Legislation is currently before the House to permit the sale of Cable and Wireless, the Radiochemical Centre and the British Transport Docks Board. This should all be on the statute book by the end of this session.

3. Management bid for National Freight Corporation

I welcome this bold and imaginative step by the management and workforce. My rhF the Transport Secretary is considering the offer with his legal and financial advisers.

4. Reasons for losses reported by BSC?

[BSC Annual Report and Accounts published on 7 July. Loss of £668m before extraordinary items. Extraordinary items £352m. Overall loss £1,020m.]

BSC's loss in 1980-81 resulted from a reduction in the Corporation's share of the home market following the three months steel strike at the beginning of 1980, a dramatic decline in demand from UK steel-using industries, and a deterioration in European steel prices.

5. BSC's future?

Major rationalisation has already taken place. As the Chairman of BSC said in presenting his

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Annual Report and Accounts: "If steel prices improve and market volumes do not fall away, and if BSC's success in improving productivity and costs continues with the full co-operation of the workforce, the measures now in hand should result in a return to profitability in the not too distant future."

6. Increase NI investment to 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.

7. 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.

8. Finance nationalised industry investment from lower pay settlements?

[In some instances settling for 12-13 per cent rises]

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.

9. 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 to bear on management for improved performance, 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.

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. 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 is 1981-82. They do not in themselves solve the deep-rooted problems of the economy.

2. 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.

3. 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.

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

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.

5. <u>UK residents should be given some kind of stake in North Sea operations?</u>

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

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PRESENT SITUATION

GDP output estimate fell ½ per cent in Q1 1981 following an average quarterly fall of 1½ per cent in 1980. Industrial output fell ¾ per cent and manufacturing output 1 per cent in May but affected by industrial disputes. Allowing for this the levels for both have been broadly flat over the first 5 months of 1981.

Consumers' expenditure rose 1½ per cent in Q1 1981. Retail sales fell further in May from the high level in January but remained higher than in any quarter of 1980. Volume of visible exports fell 2 per cent in the three months to February 1981 after being broadly flat since mid-1980. Volume of visible 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 (excluding assets leased from the service sector) fell 3½ per cent in Q1 1981 the fifth sucessive quarterly drop. Distributive and service industry investment (including leasing) fell 3 per cent in Q1 1981 but was 1 per cent above the quarterly average for 1980. DI investment intentions survey (conducted in April/May) suggests a fall in manufacturing investment after allowing for leasing of 11 to 14 per cent in 1981 with some recovery in 1982; distributive and service industries investment expected to rise by less than 5 per cent in both 1981 and 1982. Manufacturers', wholesalers' and retail stocks dropped by £0.5 billion (at 1975 prices) in Q1 1981 compared with destocking of £0.8 billion in Q4 1980 and £2.0 billion in 1980 as a whole.

Unemployment (UK, seasonally adjusted excluding school-leavers) was 2,552,000 (10.6 per cent) at June count, up 38,000 on May. Vacancies fell to 82,500 in June.

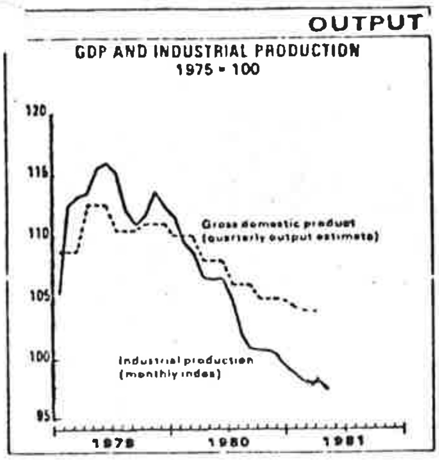
Wholesale input prices (fuel and materials) rose 1½ per cent in June to a level 14 per cent above a year earlier; wholesale output prices ("factory gate") rose ¾ per cent and are 10 per cent above a year ago. Year-on-year RPI increase was 11.7 per cent in May compared to 12.0 per cent in April. Average earnings rose ¾ per cent in April to a level 14.0 per cent above a year ago. RPDI fell by 1½ per cent in Q1 1981 after rising by 17.5 per cent over the 3 years 1977 to 1980. The savings ratio fell 2 per cent to 14 per cent in Q1 1981.

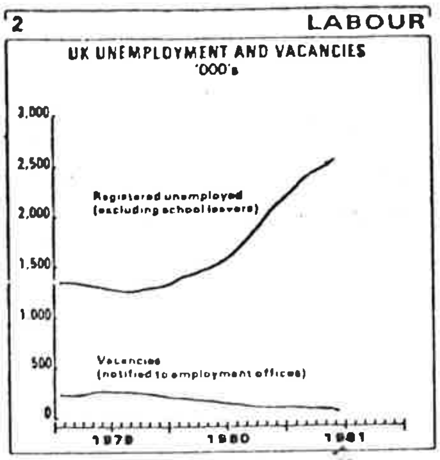
PSBR was £13.3 billion in the 1980/81 financial year. CGBR totalled £7.4 bn in the first quarter of 1981/82 but was distorted upwards by an estimated £3¼-3¾ bn due to the civil servants' dispute.

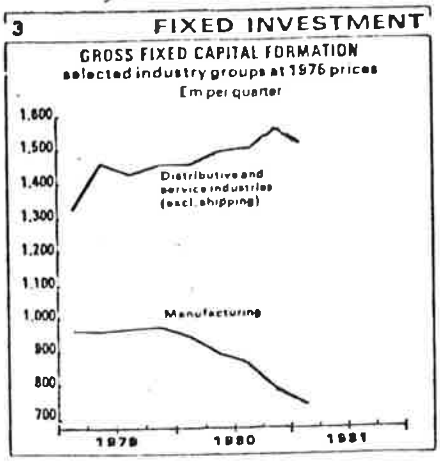
Latest banks' eligible liabilities figures suggest sterling M3 may have risen about ¼ per cent in June but distorted by the civil servants' dispute; the underlying increase since February is unlikely to be outside the 6-10 per cent p.a. target range. MLR reduced from 14 per cent to 12 per cent on 10 March.

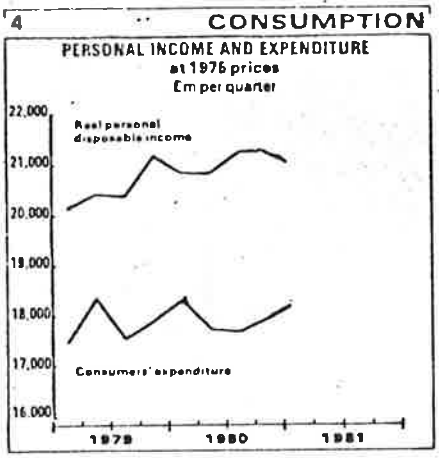
Visible trade which has been in surplus since mid-1980 showed a surplus of about £1.1 bn in the first two months of 1981. Invisibles surplus in Q1 1981 was nearly £1 bn. Reserves at end-June $25.6 bn. At the close on 10 July the sterling exchange rate was $1.8965 and the effective rate was 93.31

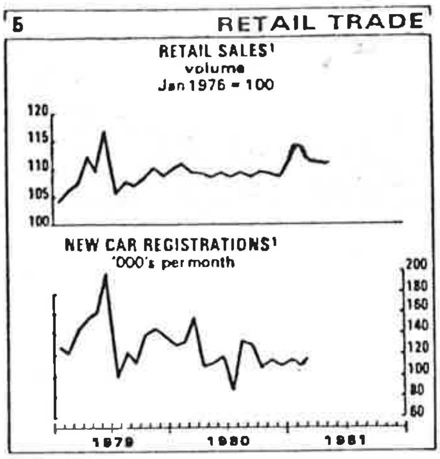
ECONOMIC INDICATORS

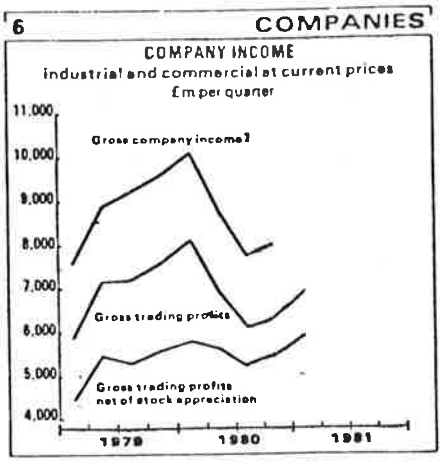


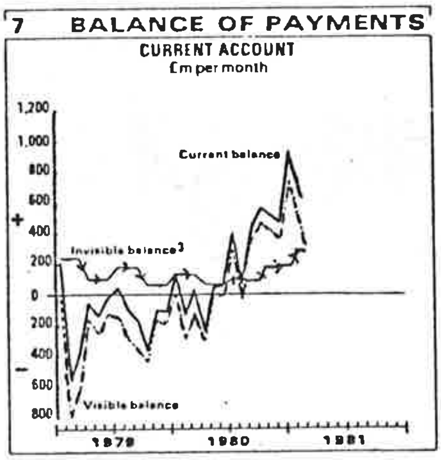


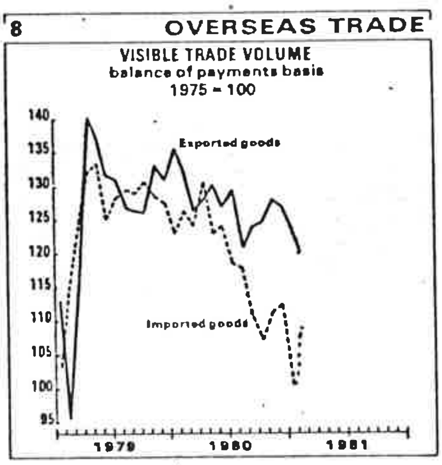


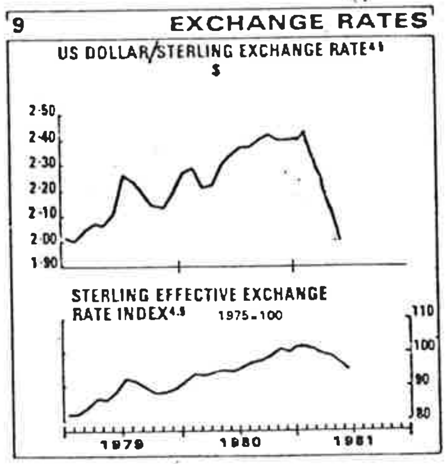


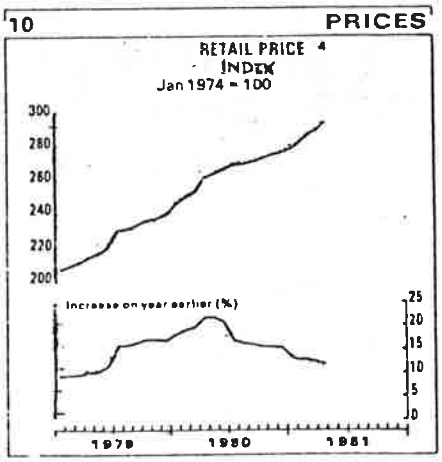


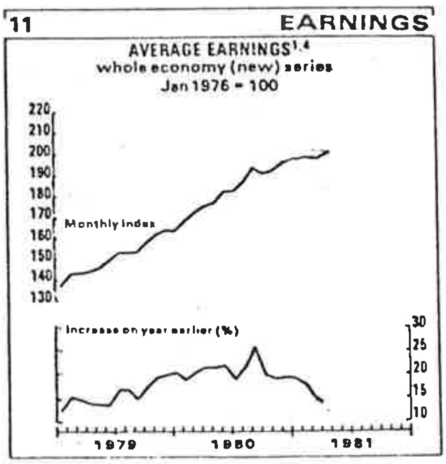


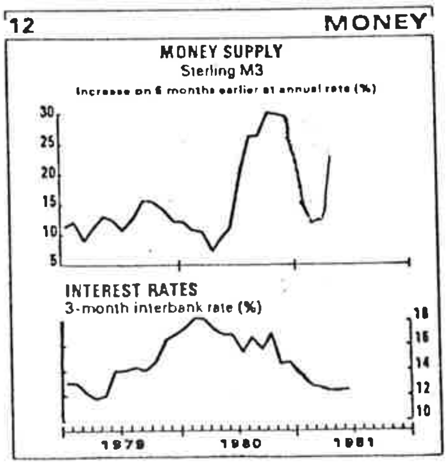












1 Excluding Northern Ireland
2 Includes gross trading profits, rent and non-trading income and income from abroad
3 Monthly averages derived from quarterly estimates
4 Not seasonally adjusted
5 Monthly averages of daily rates

Marc Roger. he Jo...

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CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir K Couzens
Mr Hancock
Mrs Hedley-Miller
Mr Ashford
Mr Edwards
Mr P R C Gray
Mr Macrae
Miss Leahy

VISIT OF EURO JOURNALISTS, FRIDAY 17 JULY

You are seeing some Brussels-based foreign journalists at 11.30 am tomorrow, for about 45 minutes. Mr Macrae is briefing about ground rules, and about the journalists' background.

2. I suggest you start with some short remarks, largely about restructuring, and then throw open the discussion. I attach an introductory speaking note, and a few notes for questions.

3. I am supplying your Private Office with copies of the Hague speech, which can be made available to the journalists.

4. I also attach (top copy only):-

a. the notes for supplementaries which you took to the Hague;

b. a Foreign Office summary of the Commission's report on restructuring;

c. a note by Mr Ashford on the current Community budget exercise; and

d. a background note by Miss Leahy on the journalists' home economies.

You may also like to include in the folder:-

e. the weekly economic brief; and

f. the briefing for Ottawa on the international situation, including interest rates - PMVL(81)2.

Robin Culpin

R P CULPIN
16 July 1981

OPENING REMARKS

1. Understand you have already discussed our general approach to the Presidency with Sir Ian Gilmour. Whole Government committed to making a success of it.

2. Appropriate for me to concentrate on Treasury matters. No shortage of issues - the challenges facing our economies, the current preparations for Ottawa, and so on.

3. But on economic side, centrepiece of our Presidency bound to be the negotiations on reforming the Community budget. Progress crucial to Community as whole. UK has special interest, but problem goes wider - Germans, enlargement, approach of 1 per cent ceiling.

4. Offered own analysis in Hague speech on 3 June - offer copies. Crux of the problem is that the impact of the budget on member states is unplanned: it results from a whole series of decisions taken in different contexts for different purposes. Suggested in the Hague that Community ought in future to decide consciously the way in which the budget should affect member countries. These decisions should be based on objective and defensible criteria, including relative prosperity. Approach would ensure directly that budget burdens and benefits are shared equitably.

5. Also said in Hague that Community must tackle complex of problems connected with agriculture. Major elements of the solution include reducing real support levels for products in excessive surplus, giving greater play to market forces, and subjecting agricultural spending to financial disciplines.

6. Since spoke in the Hague, Commission has produced the proposals you will have seen. Glad to have these on the table. Look forward to considering with our partners how they measure up to the problems the Community faces.

7. Interested to hear what reception the report has received in your countries.

NOTES FOR QUESTIONS

UK response to Commission report

Early days yet. Report a useful starting point. Recognises need to improve operation of CAP and to correct UK's inequitable budgetary situation. Makes some interesting suggestions as to how to achieve these aims. Naturally, we are particularly interested in the suggestion that some continuing correction should be made for the UK's low receipts from the CAP.

On the other hand, Commission could have cast their net a bit wider in search for solutions. Problem of budgetary imbalances is not just a UK one. The 30 May agreement makes clear that the aim is to avoid an unacceptable situation for any member state. Also clear that Community needs a lasting solution. Yet the particular scheme suggested by the Commission would be confined to the UK, and temporary. One of the questions we and our partners will have to ask ourselves is whether the proposal might be adapted to provide a broader and permanent solution, enabling the Community to tackle the common budget problem directly.

Effect of Commission's proposals on the UK

No figures in Commission's report. Effect would depend on all sorts of details which will have to be discussed in the Community. Too early to give estimates.

UK response to CAP aspects of Commission report

Initial impression is that Commission proposals have much in common with our approach, for example on levels of price support, measures to limit surplus production and limits on CAP spending. But there is much to be considered and explored in coming months.

UK response to proposals on Regional and Social Funds

Agree with Commission that there should be greater concentration on areas of particular need. Attach importance to alleviating problems of decline in traditional industries and of youth unemployment. The more effectively agricultural spending can be controlled, the more scope there will be to expand these funds within the 1 per cent ceiling.

Presidency gives UK unfair advantage

Of course UK has special interest. We are one of the poorer countries of the Community, and our living standards are falling; yet before refunds, we have the largest net contribution, and it is rising. But restructuring is not just a British concern. Must be sorted out if Community is to make progress on other fronts. No intention of abusing our position.

HAGUE SPEECH : NOTES FOR SUPPLEMENTARIES

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1. Purpose of speech

Speech is intended as constructive contribution to debate in Community on CAP and budgetary reform - before we enter negotiating phase. Concerned only with broad approach. Wrong to go into technical details ahead of Commission report. No wish to pre-empt that report.

2. Handling of mandate

Discussion at June European Council will necessarily be preliminary. Our firm aim must be to reach solution at November European Council, in accordance with timetable agreed on 30 May last year.

3. What if no agreement in November?

Community is committed to rolling forward special arrangements for UK for a third year.

SUBJECTS NOT COVERED IN SPEECH

4. Fish

Contrary to many press reports, the UK has made sincere and continuing efforts to reach agreement on a common fisheries policy. We have made substantial concessions. Some further delay now inevitable following change of government in France. But UK will work hard for the early solution which the Community so badly needs.

5. EMS

The UK is a member of the European monetary system. We remain ready to join the exchange rate arrangements when this can be done without damaging the UK's domestic monetary policies or upsetting the arrangements themselves.

6. Other subjects

There are many other subjects which are important and on which we need to make progress. I have concentrated on the budget and the CAP only because I think these are currently most important issues of all.

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7. **Are we suggesting that the real incomes of farmers must be further reduced?**

Farmers cannot be completely insulated from the economic pressures to which others are subject. I am afraid they are by no means the only group for whom adjustments may be painful.

8. **UK attitude to income aids for small farmers**

It is right to consider whether they have a role to play in easing the adjustment process. But they need to be coordinated at Community level, to make sure that they do not undo the effects of price restraint.

9. **What is meant by giving greater play to market forces?**

Community cannot ignore the balance of supply and demand in the market or world price levels for agricultural products. Nor can Community prices be set without reference to the interests of consumers and of European taxpayers.

10. **Support prices and expenditure on support cannot be fixed simultaneously**

This is a difficult subject. But as I have said, we have to do all we can to keep the growth of agricultural spending below the growth of own resources. I do not see how we can afford completely open-ended commitments, either at home or in the Community.

11. **Linear co-responsibility levies**

These do not provide a satisfactory solution to the problem of surplus production and the economic and financial burden which this imposes on the Community. "Super-levies" designed to discourage over-production seem to offer a much better solution.

BUDGETARY IMBALANCES

12. <u>Anathema to talk about net contributions and receipts of individual member states at all?</u>

With respect, cannot possibly accept that. Community recognised last May that UK net budget contribution was a genuine problem and that similar problems could arise for other member states. Cannot solve these problems by pretending they are not there. Must recognise them and find lasting solutions before they damage Community beyond repair.

13. '<u>Juste retour</u>'?

Not advocating 'juste retour', in sense that everyone should get back exactly what he puts in. Suggestion is rather that Community should adopt a principle universally recognised in national states - that resources should flow from more to less prosperous regions, and not vice versa.

14. <u>How solve budgetary imbalances problem without raising 1 per cent VAT ceiling?</u>

Can contribute to solution by redeploying expenditure away from agriculture into other areas within the 1 per cent ceiling. Realistically, however, special corrective arrangements will be needed too. Unwelcome to some. But better than making complete nonsense of Community policies. Special arrangements should be financed in ways which do not conflict with VAT ceiling.

15. <u>Form of special corrective arrangements</u>?

Wrong for me to pontificate on technical details ahead of Commission report. Suffice to say that the work we have done suggests wide range of technical possibilities.

16. <u>Corrective mechanism would remove member states' interest in Community policies?</u>

Cannot accept that. As I said earlier, argument virtually amounts to saying that member states will only conduct policies at Community level if they see prospect of obtaining direct national financial advantage at expense of other member states.

Fact is that <u>lack</u> of any corrective mechanism is making it impossible for Community to agree on development of its policies: net contributor countries cannot afford to risk further increases in their net contributions.

Making distributional impact of budget a matter of conscious decision should <u>improve</u> Community decision making by removing financial in-fighting between member states.

17. <u>Corrective mechanism would destroy own resources system?</u>

Aim would be to preserve existing budgetary arrangements, not to dismantle. Own resources would be paid over in exactly same way as now. All I suggest is that we need to complete Community's budgetary arrangements by adding one further principle.

18. <u>Why not another special arrangement for UK?</u>

Because not just a UK problem. German problem as well, and hence a Community problem. Enlargement will make problem worse. Must find lasting solution which will solve the problem of unacceptable situations for any member state, as agreed on 30 May last year.

19. <u>UK keeps trying to renegotiate entry terms</u>

Assure you we take no pleasure in that at all. We all hoped that the budget problem which some foresaw would not in fact materialize. But it <u>has</u> materialised, and it has not been solved. We have to face it and tackle it

/once and for all.

once and for all. We must get a permanent solution, so that we don't have to keep arguing from first principles year after year.

20. <u>UK brings problem on itself by importing so much from outside Community</u>

No. Our payments of "own resources" are a relatively small part of the problem. The larger difficulty is that we get such a small share of Community receipts.

In point of fact, the pattern of our trade has shifted substantially towards the Community. But like the Dutch, we have a long history of wide trading - and the government directs neither traders nor consumers.

COMMISSION REPORT ON 30 MAY MANDATE : SUMMARY

Paragraphs 1-16. Introductory. Community must adopt joint strategy to cope with present problems affecting it. Community activities must be developed and this means raising current limit on own resources. Community has so far mainly developed through common market and common agricultural policy. It is about more than just the budget. Should make progress towards economic and monetary union through greater coordination between Member States and development of EMS, once all Member States participate in it. Commission will propose precise targets for energy policy: energy-saving, expanding means of energy production, building infrastructure, diversifying sources and encouraging use of new forms of energy. These activities to be financed by coordinating national resources and greater use of Community intruments. Commission will support priority research programmes in energy, the agri-food industry, environmental protection, nuclear satefy and biotechnology. Vital for Community to make its contribution to development of new technology and industries. Such development particularly important for small and medium sized farms. Active and extended EC competition policy essential.

Paragraphs 17-31. Common Agricultural Policy

CAP has achieved Treaty objectives. 3 basic principles - market unity, Community preference, financial solidarity - remain essential. But Community now more than self-sufficient in most major products. Commission has concluded that it is not right to give producers a full guarantee for products in structural surplus, and prices should reflect market realities more than in the past. It therefore recommends:-

(a) a price policy based on narrowing the gap between Community prices and those of its main competitors and a hierarchy of prices designed to improve its balance of production;

(b) a more active export policy designed to stabilise world prices by means of cooperation agreements with other major exporters, and probably supplemented by long-term export contracts - Commission also to monitor some imports:

(c) setting production targets at Community level for each sector - once these are reached producers would have to contribute or intervention guarantee would be reduced - for milk, this means extending coresponsibility or other measures;

(d) possibly income aids to smaller farmers in specific circumstances, partly financed by Community;

(e) stricter control of national aids;

(f) Commission to propose by end 1982 programmes for Mediterranean agriculture covering incomes, markets, production and structures - CAP should apply without discrimination to Mediterranean products, and changes should not lead to a drop in living standards for those involved.

Implementation of these guidelines will mean that CAP spending will grow less rapidly than own resources.

<u>Paragraphs 32-40</u>. <u>Regional and Social Policies</u>

Resources available should be concentrated on areas of greatest need and Community expenditure should be additional to national.

/Quota

Quota section of Regional Fund should be focussed even more on regions suffering severely from structural under-development. Expanded non-quota section to be directed to regions with serious problems of industrial decline or suffering from effects of certain Community policies. Fund to support programmes rather than individual projects as now.

Social Fund should be redirected to job creation, including aids for essential support services in fields of information, guidance and technical assistance, and training young people. Fund to have greater flexibility in operation. Resources for the Regional and Social Funds should grow faster than total budget. They should be combined as appropriate with Community loans to provide interest rate subsidies for major programmes in certain priority regions. Loans should also be used especially to help small and medium-sized companies. Community's own resources should be increased when necessary to achieve agreed objectives.

Paragraphs 41-50 UK Problem

Will take time for these policies to have significant impact. Of six main categories of expenditure, one, FEOGA Guarantee, places UK in inequitable situation. Size of imbalance to be corrected could be assessed by comparing UK's share of Community GNP with proportion UK receives of Guarantee expenditure. Amount of compensation to be established according to simple rules using a reference period of several years and with a view to a fairly high level of compensation. This should be financed by own resources. If resources not available, could be financed by abatements of other Member States'

/receipts

receipts from the Community based on the payments they receive under FEOGA Guarantee and with regard to relationship between richer and poorer Member States. UK refunds to be spent on activities which accord with Community policies and increased economic convergence. This system should apply for a limited period but long enough for the effects of the new proposals to be felt. Review before the period expires. As for existing financial mechanism, Commission will report by end 1981 so that mechanism will continue in being if it is needed.

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THE CURRENT COMMUNITY BUDGET EXERCISE

The EC Budget Council will be meeting in Brussels on Thursday 23 July; the Financial Secretary to the Treasury will preside and the UK will be represented by the Minister of State (Mr Rees). The Council will consider proposals by the Commission in a Preliminary Draft Amending Budget for 1981 and in the Preliminary Draft Budget for 1982.

2. The meeting of the Council will be preceded by a meeting the previous day between the Council and a Delegation from the European Parliament in order that Ministers may learn the Parliament's views on the Commission's Budget proposals. Since the Council and the European Parliament together form the Community's "budgetary authority", this is a necessary part of preparation for the Budget Council. It provides an opportunity for an exchange of views between the Council and Parliament on priorities for the Budget.

3. The Commission have put forward their proposals for amending the 1981 Budget against the background of a dispute between certain Member States (not including the United Kingdom) and the Commission resulting from decisions taken at the end of last year. This dispute is still unresolved but it may well be that a satisfactory agreement, if this can be reached, between Member States in the Council, and between the Council and the Parliament, will contribute significantly to a political resolution of the dispute. The main features of the Commission proposals in the Amending Budget are a substantial reduction of 1981 provision for agricultural Guarantee expenditure, offset by increased provision for the Regional Fund and for certain other purposes. We are favourably disposed towards these proposals.

4. The Commission's proposals in their Preliminary Draft Budget for 1982 have been tabled in accordance with the timetable laid down by the Treaties. They have been under discussion between Member States at official level and it will be the task of the Budget Council on 23 July to "establish" the Draft Budget which is then forwarded to the European Parliament for its consideration. The Parliament's views will be further considered by the Council of Ministers later in the year.

5. It will be our aim, as Presidency, to seek to ensure that consideration of the Commission's proposals takes full account of the economic and financial situations of Member States and in particular the concern in almost all such states to restrain public sector deficits and to exercise most stringent control of public expenditure. Clearly, when Member States Governments are having to examine their programmes of domestic expenditure extremely critically, it is also essential to ensure a similar examination of proposals for expenditure at the Community level. Within this framework, we shall aim, both as UK and as Presidency, to ensure that the Budget reflects the Community's needs. In this connection I would hope that Member Governments will recognise the need to restrain provision for CAP expenditure in the 1982 Budget, recognising that developing new areas of expenditure, for example expenditure related to current situations of unemployment in Member States, would only be possible through a shift in the balance of the Budget.

BACKGROUND NOTE ON EURO-JOURNALISTS' COUNTRIES OF ORIGIN

Germany

The German economy is characterised by sluggish activity, a large current account deficit, very high real interest rates and an inflation rate which, though very low by international standards, has not come down over the last 12 months. The Germans are very gloomy about all this, probably unnecessarily so. Although GNP is likely to fall this year industrial production has increased substantially in recent months. The official forecast that the deficit in 1981 may be as high ($16 billion) as in 1980 could be pessimistic; in April the current deficit was very small, the trade surplus was the largest for over two years and export orders are buoyant. The trend of inflation has largely reflected the depreciation of the D Mark; the spring 1981 wage round was moderate, with settlements averaging 4½ per cent.

2. In political terms, the German budget has caused a major row. In 1982 the federal deficit is likely to be around 25 per cent more than originally forecast. The recession has pushed up public expenditure. Large and controversial spending cuts will be necessary to meet the target for the deficit in 1982 (DM 26 billion, compared with a likely outturn of DM 35 billion in 1980).

France

The French economy is still in the throes of the recession with a turn-up expected at the end of the year. Recent French measures should add a little to growth but inflation and the balance of payments will worsen. Unemployment may continue to rise despite proposed job creation measures. The budget deficit is likely to reach 2 per cent of GDP this year and perhaps 3 per cent thereafter when all the socialist economic policies have been carried out.

Italy

The new Italian Prime Minister Signor Spadolini has re-affirmed support for measures to tackle some of the economy's underlying problems. He hopes to reduce the budget deficit from its present annual rate of nearly 50,000 billion lire to the previously planned target of 37500 billion lire by reducing spending on social security, health and education and regional transfer payments. He has also re-started talks with unions and employers about the sorely needed modifications to the scala mobile pay indexation system. Agreement on both issues will be difficult to achieve. In the meantime GDP may fall this year and inflation and the balance of payments are deteriorating.

Denmark

Since mid-1979 the Danish authorities have aimed to restructure the economy by curtailing public consumption, cutting real disposable income and releasing resources to the private sector. Successive rounds of public expenditure cuts and indirect tax increases have been undertaken. Firms are still being squeezed by high interest rates but they are now benefitting from falling real pay and a more competitive exchange rate. But accelerating inflation (about 12 per cent in the year to April 1981) because of the exchange-rate depreciation and the ending of the price freeze in February, may wipe out this gain in competitiveness by the end of the year.

16/7/81.

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1. MRS GILMORE

2. CHANCELLOR

cc Mr Monaghan
Mr Culpin
Miss Edwards

VISIT OF EUROJOURNALISTS, FRIDAY 17 JULY

You have agreed to see these journalists at 11.30 tomorrow for about 45 minutes. Mr Culpin is providing separate/ policy briefing direct. The FCO have not divulged much of interest about these particular journalists, but I pass on what I have managed to glean. The main general points are:-

1. They are all Brussels-based and cover all EC, NATO etc matters.

2. They are not particularly economic specialists, although reasonably economically literate. They have to deal with all EC matters, rather like Lobby correspondents.

3. Their English is very good in some cases, not so good in others. But there is no need for an interpreter.

4. On-the-record or unattributable? Unless you particularly want to go completely "on-the-record" (as they would no doubt prefer) I suggest that we, as often, make it "unquotable" in general (rather than "unattributable", as they will want to say they have seen you) unless they ask if they can quote particular bits. (This was the sort of arrangement we made with Joe Livingstone, for instance.)

5. Miss Edwards will be sitting in on the interview for IDT.

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