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SECRET AND PERSONAL

RD

ECONOMIC SECRETARY TO THE TREASURY

FROM: P D P BARNES
DATE: 23 September 1987

PS/CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Cassell
Mr Sedgwick
Mr Peretz
Mr Kelly
Miss O'Mara
Mr Bottrill
Mr Culpin
Mr Davis
Mr Owen

AUGUST TRADE FIGURES

The Economic Secretary has seen Mr Davis' submission to the Chancellor of 22 September.

2. In defensive 6, the Economic Secretary thinks that it would be useful to include the FSBR forecast of exports as background.

3. The Economic Secretary also thinks that a defensive line is needed to two further questions:-

i. "Monetary/fiscal action needed to rein back growth of economy and imports?"

The Economic Secretary suggests the line:

"FSBR and most outside forecasts predicted economic growth will return to trend level even before recent tightening of monetary policies."

ii. "Import boom consequence of pre-electoral relaxation?"

The Economic Secretary suggests:

"Last budget tightened fiscal stance by £3 billion - lowest PSBR as percentage of GDP since [ ]. This permitted some reversal of earlier increases in interest rates, but rates still kept at positive real level to keep downward pressure on inflation"

PB

P D P BARNES
Private Secretary

RC 96

SECRET AND PERSONAL

FROM: CATHY RYDING
DATE: 23 September 1987

MR P DAVIS

cc Chief Secretary
Financial Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Cassell
Mr Sedgwick
Mr Peretz
Mr Bottrill
Mr Kelly
Miss O'Mara
Mr Culpin
Mr Barrell
Mr Owen
Mr Norgrove - No.10

AUGUST TRADE FIGURES

The Chancellor was grateful for your minute of 22 September.

2. The Chancellor had the following comments on the draft briefing for IDT:-

<u>Positive 3</u> - Delete.

<u>Defensive 1</u> - Insert "August figure erratically high last year" after second sentence. Redraft third sentence to read "Deficit in first eight months of 1987 only £$\frac{3}{4}$ billion - very small as share of GDP ($\frac{1}{4}$ per cent), much smaller than imbalances in other major countries and smaller than implied by Budget forecast of deficit of £2$\frac{1}{2}$ billion for 1987 as a whole".

<u>Defensive 4</u> - Redraft penultimate sentence to read "Not surprising given that UK economy is growing faster than most other major economies, which are currently under-performing".

3. More generally, the Chancellor has commented that the briefing needs to get across the simple message that the current account deficit is a non-problem unless there is evidence of inflationary pressure—which other evidence does not support.

CR

CATHY RYDING

SECRET AND PERSONAL
UNTIL 11.30 am THURSDAY 24 SEPTEMBER
THEN CONFIDENTIAL

The export figures contain some modest encouragement but the rise in imports has been rapid recently even if the August figure is erratic.

FROM: PAUL DAVIS
DATE: 22 SEPTEMBER 1987

1. MR BOTTRILL AB 22/9
2. CHANCELLOR OF THE EXCHEQUER

cc: See attached list

Content with press briefing?

NMcE @ EW

OR 22/9.

AUGUST TRADE FIGURES

The August trade figures will be published at 11.30 am on Thursday 24 September. They will show a deficit on visible trade of £1529 million. Combined with an unchanged CSO projection of the monthly invisibles surplus of £600 million, they give a projected current account deficit of £929 million in August compared to a deficit of £310 million in July. In the three months to August the current account was in deficit by £1249 million compared to a surplus of £22 million in the previous three months. In the first eight months of the year, the current deficit was £741 million.

2. This month's visible and current account deficits are the largest ever recorded in nominal terms. The previous largest was recorded in August 1986. As a percentage of GDP the current deficit in August was 3¼ per cent still below the 3¾ per cent recorded in February 1979 and 4½ per cent recorded in 1974.

3. There may be some suggestion that August is a seasonally unfavourable month - particularly in view of the sharp increase in the current deficit between July and August 1986. Changing holiday patterns make seasonal adjustment difficult in August. A statistical examination earlier this year concluded that the evidence for residual seasonality in the August current balance was very weak, and scrutiny of recent years does not show any clear pattern in the August balance compared to neighbouring months. In the present instance, the DTI has adjusted the value of exports upwards by 18 per cent and the value of imports by 16 per cent to try to take account of both seasonal factors and the number of working days in the month. The unadjusted visible trade deficit in August was £1429 million which is £100 million less than the adjusted deficit but still uncomfortably high. August is the first month since March not to be affected by unprocessed documents resulting from the strike by Customs computer staff at Southend.

Main points

4. **Current account** £ million

	1986 Year	Q3	Q4	1987 Q1	Q2	June	July	Aug
Manufactures	-5491	-1741	-1826	- 736	-1860	-512	-625	-1284
Oil	4056	621	785	1164	1033	245	284	374
Other goods	-7028	-1771	-1684	-1563	-1534	-473	-569	-619
Total visibles	-8463	-2891	-2725	-1135	-2361	-740	-910	-1529
Invisibles	7483	1981	1765	1807	2187	729	600*	600*
Current balance	- 980	- 910	- 960	672	- 174	-11	- 310*	-929

* projection

5. The value of exports fell by £0.2 billion between July and August and imports rose by £0.4 billion; hence the visible deficit in August was £0.6 billion greater than in July. In the three months to August the visible deficit was £1.1 billion larger than in the previous three months reflecting a £0.8 billion rise in the non-oil deficit and a £0.3 billion fall in the oil surplus. Over the same period the manufacturing trade deficit widened by around £0.8 billion to £2.4 billion. This is rather larger than the average quarterly deficits of £1.8 billion in the second half of 1986.

6. In the balance of payments press notice published on 17 September, the invisibles surplus for the second quarter was preliminarily estimated at £2.2 billion and the figure for the first quarter was revised up by £170 million to £1.8 billion. The CSO has reassessed, but made no change to its projection of a surplus of £600 million a month for the third quarter. This is partly because some of the factors leading to the greater than expected surplus in the second quarter are thought to be temporary (eg the high credit figure on travel and the abnormally high net premiums earned by Lloyds), and partly because a repayment scheduled from the EC for the third quarter had been made in the second quarter.

7. **Exports**

	percentage change		
	August on July	3 mths to August on previous 3 mths	3 mths to August on same period year earlier
Total value	-3½	1½	14
Total value excl. oil and erratics	-2½	3½	11
Total volume	-3½	-½	5
Total volume excl. oil and erratics	-3½	3	7½
Manufactures volume (excl.erratics, OTS basis)	-3	3	7
Fuels volume (OTS)	6	-11	-4
Basic materials volume (OTS)	18	3	6
Food, drink and tobacco volume (OTS)	-4½	3½	1½

8. Export volumes, excluding oil and erratics, fell by 3½ per cent in August reflecting falls in exports of manufactures and food, drink and tobacco. However in the three months to August export volumes of manufactures, basic materials and food, drink and tobacco were all higher than in the previous three months, offset only partly by a fall in fuel exports reflecting the summer maintenance shutdown in the North Sea, although oil exports recovered in August.

9. The underlying trend in export volumes remains difficult to assess, largely due to the erratic quarterly path of the last year. Recent figures are probably consistent with modest growth in underlying exports over the last few months, suggesting a resumption of the upward trend which began early in 1986.

10. Imports

	percentage change		
	Aug on July	3 mths to Aug on previous 3 mths	3 mths to Aug on same period year earlier
Total value	5	7	15
Total value excl. oil and erratics	6½	7	13
Total volume	5	7	8
Total volume excl. oil and erratics	6	7	10
Manufactures volume (excl.erratics, OTS basis)	7½	8½	11
Fuels volume (OTS)	1	21	-7
Basic materials volume (OTS)	4	-2	15
Food, drink and tobacco volume (OTS)	2½	1½	-2½

11. Import volumes, excluding oil and erratics, rose by 6 per cent in August, reflecting a sharp rise in imports of manufactures and smaller increases in other broad categories. Within manufactures, the strongest rises came in consumer goods, especially passenger motor cars and semi-manufactures. Imports of capital goods fell in August. However over the past year intermediate and capital goods have made a strong contribution to import growth, reflecting the strong expansion of output.

12. The quarterly path for imports, like that for exports, has been erratic recently with a sharp rise in the latter half of last year followed by a large fall in early-1987. The recent figures indicate a renewed upward trend in imports, although after taking into account the erratically low levels at the start of this year this underlying increase is perhaps slower than suggested by the three month on three month comparison. The volume of non-oil imports (excluding erratics) in the year so far is about 9 per cent higher than a year ago.

They haven't yet had time to investigate series in detail. Cutts will ring if interesting points emerge.

Geographical area

13. The value of exports to the US fell back in August but in the three months ending August was still 4 per cent higher than in the previous three months. Exports to the EC rose by 1 per cent in the same period but exports to oil exporters fell by 3 per cent. Exports to Japan rose by 2 per cent in August and in the three months to August were 17 per cent higher than in the previous three months.

Trade prices

	percentage change			
	Import prices (OTS)		Export prices (OTS)	
	Aug on July	3 mths to Aug on previous 3 mths	Aug on July	3 mths to Aug on previous 3 mths
Manufactures (excl.erratics)	½	-½	1	½
Food, drink, tobacco	-½	-1	½	½
Basic materials	1	1	-½	1½
Fuel	3	1	6½	5
Total (BOP basis)	1	-½	1½	1
Total less oil(BoP basis)	½	-½	1	½

14. In the three months to August the total terms of trade and the non-oil terms of trade as measured by unit value indices both improved by 1 per cent compared to the previous three months. Over the same period the exchange rate has been broadly flat whilst oil prices have risen, offset by a rise in commodity prices in SDR terms. The terms of trade are still improving since export and import prices respond with a lag to changes in the oil price and exchange rate in particular. (NB: the published series are unit value indices, which can present a misleading picture over a period of time due to their use of 1980 weights.)

Comparison with Treasury forecasts

NOT FOR USE

15. The recent increases in non-oil import volumes take them above the quarterly levels underlying the published FSBR forecast and also above those in the internal June forecast. The volume of non-oil exports is broadly in line with both the FSBR and summer internal forecasts. The current deficit of £0.7 billion so far this year is rather smaller than expected at the time of the FSBR but larger than the summer forecast.

Market expectations

16. The market expectation is for a current account deficit of £200-250 million in August. The August deficit is far larger than expected by the City, and is likely to be received badly.

Press briefing

17. I would be grateful for clearance of the attached press briefing.

Briefing OK as amended by self & AA. But need to get across some message that c/a deficit a non-problem unless evidence of reflecting other pressures, which evidence does not support. N.

PAUL DAVIS

EA2

SECRET AND PERSONAL
UNTIL 11.30 am THURSDAY 24 SEPTEMBER
THEN UNCLASSIFIED

DRAFT BRIEFING FOR IDT

Positive

1. Export volumes (excluding oil and erratics) in three months to August 7½ per cent higher than a year earlier.

2. CBI Survey for September shows export order books still above normal.

~~3. Terms of trade (both including and excluding oil) in three months to August improved by 1 per cent over previous three months.~~

Defensive

1. Current account deficit highest ever recorded: Wrong to attach too much importance to one month's figures. Recent monthly figures volatile. August figure erratically high last year. Deficit in first eight months of 1987 only £¾ billion - very small as share of GDP (¼ per cent), much smaller than imbalances in ~~G3~~ other major countries and smaller than implied by ~~FSBR~~ Budget forecast of deficit of £2½ billion for 1987 as a whole.

2. Current deficit widening. Current deficit of £741 million for year so far lower than £1870 million deficit in second half of 1986. Out-turn so far this year still better than expected at Budget time.

3. Trend in imports strongly upwards - domestic demand growing too fast? Recent figures very erratic, but inevitable that there should be some rise in imports as the economy expands. Imports of basic materials, semi manufactures, capital and intermediate goods have made strong contribution - as anticipated in FSBR forecast.

4. Imports rising faster than exports [In three months to August on a year earlier, import volumes (excluding oil and erratics) up 10 per cent, compared with 7½ per cent rise for exports. On previous three months import volumes up 7 per cent while exports up 3 per

cent.] Not surprising given that UK economy is growing faster than most other major economies. As growth overseas picks up, UK exports should benefit.

which are currently under-performing.

5. Exports no longer growing. In three months to August export volumes (excluding oil and erratics) 7½ per cent higher than same period a year ago. Volume of manufactures exports 7 per cent up over same period.

6. FSBR forecast for growth in exports in 1987 too optimistic: Exports forecast to grow in 1987 as world trade rises and benefits of improved competitiveness continue to come through. Latest CBI survey show export orders still above normal. Export volumes (excluding oil and erratics) 7½ per cent higher in three months to August than a year ago.

7. FSBR forecast of £2½ billion current account deficit in 1987 too optimistic: Out-turn so far this year better than expected. Current account of balance of payments shows only modest deficit in year so far.

8. Capacity constraint threatens current account performance. [Phillips and Drew forecast 2 July 1987 stated export boom unlikely to last as competitiveness declines and imports likely to increase since industry facing capacity constraint.] Always expected imports to rise as economy grows strongly. Industrialists report capacity utilisation relatively little changed over past year. CBI in latest quarterly survey states "there is no evidence of widespread bottlenecks due to fixed capacity over the next twelve months".

9. Non-oil tradeable sector unable to respond owing to erosion of manufacturing base. Manufacturing industry doing very well - output up 6 per cent comparing latest three months with a year earlier. CBI surveys consistently optimistic. Volume of manufacturing exports (excluding erratics) 7 per cent higher in three months to August than a year earlier.

10. Fall in exchange rate needed - sterling's recent strength threatens competitiveness: Period of stability in exchange rate now desirable - sentiment endorsed by CBI.

11. Invisibles projections for July and August imply fall from 1987Q2 surplus. Projection for July and August based on latest but incomplete information. Surplus of £2187 million in 1987Q2 reflected substantial improvement but too soon to say whether it reflects rise in strong underlying invisibles balance.

12. UK's external position precarious: No problem. Current deficit small so far in 1987. FSBR forecast of current account deficit for 1987 as a whole only ½ per cent of GDP, following cumulative current account surplus of almost £20 billion between 1979 and 1986. With net overseas assets worth around £114 billion by end-1986, overall external position unprecedently strong.

TRADE FIGURES FOR AUGUST 1987

Advance circulation

Chancellor
Chief Secretary
Economic Secretary
Financial Secretary

Mr Peretz
Mr Kelly
Miss O'Mara

Sir P Middleton
Sir G Littler
Sir T Burns
Mr Cassell
Mr Sedgwick

Mr Culpin
Mr Barrell
Mr Owen

Mr Norgrove - No.10

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Mr Tyrie
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MR 3/11

SECRET AND PERSONAL

FROM: CATHY RYDING
DATE: 23 September 1987

PS/ECONOMIC SECRETARY

cc: Sir P Middleton
Sir T Burns
Mr Cassell
Mr Peretz
Mr C W Kelly

AUGUST OVERSEAS TRADE FIGURES

The Chancellor has seen your minute of 22 September.

2. The Chancellor has commented that he agrees that there is something highly suspect about the current system of seasonal adjustments.

CR

CATHY RYDING

3764/083

SECRET AND PERSONAL

FROM: P D P BARNES
DATE: 22 September 1987

PS/CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Cassell
Mr Peretz
Mr C W Kelly

AUGUST OVERSEAS TRADE FIGURES

The Economic Secretary has commented that there seems to be a clear seasonal pattern in the imports figures (less oil and erratics) even after seasonal adjustment, as there has been a peak in October/November in each of the last three years.

?

I agree that this [illegible] highly suspect as the current system of seasonal adjustment

PB

P D P BARNES
Private Secretary

PUP

DTI Press Notice

Department of Trade and Industry
1 Victoria Street SW1H 0ET
Press Office: 01-215 5060/5066
Out of hours: 01-215 7877

Number: 87/555

Date: 24 September 1987

RELEASE DATES FOR MONTHLY OVERSEAS TRADE FIGURES - 1987

The intended dates for the release of the monthly United Kingdom overseas trade figures for the rest of 1987 are shown below. The figures are issued jointly by the Department of Trade and Industry and the Central Statistical Office. The dates for the more detailed 'Overseas Trade Statistics' published by HM Stationery Office are also shown.

Month to which figures refer	Press Notice containing provisional monthly overseas trade figures issued at 11.30am	Detailed 'Overseas Trade Statistics' in book form by HMSO
September	Friday 23 October	Wednesday 11 November
October	Tuesday 24 November	Friday 11 December
November	Wednesday 23 December	Thursday 14 January 1988
December	Thursday 28 January 1988	Friday 12 February

ENDS

1236/39

1 Andrew
2 PWP

NP cc Miss O'Mara

FROM: MARK CALL
DATE: 25 SEPTEMBER 1987

CHIEF SECRETARY

do you think we sd show this to someone like mom – is it OK?
CR

cc PS/Chancellor
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Cropper
Mr Tyrie

MANUFACTURING INDUSTRY

You asked me to pull together the basic facts on the state of the manufacturing sector. Sources other than the TWEB are indicated in parenthesis.

2. GDP growth

- Seventh successive year of growth at annual rate of almost 3 per cent.

- Since 1980 UK has grown faster on average than other major EEC countries. Over previous 2 decades UK was bottom of growth league.

1960-70	1970-80	1980-86
Italy	France	**UK**
France	Belgium	Italy
Belgium	Netherlands	France
Netherlands	Italy	Germany
Germany	Germany	Belgium
UK	**UK**	Netherlands

3. Manufacturing output

- Manufacturing output up 5.5 per cent over last 12 months. (Fastest pace of output growth for 15 years: Daily Telegraph).

- Manufacturing output is now 0.5 per cent above the level in 1979; and 19 per cent above the 1981 H1 trough.

- The new peak is still 2 per cent below the peak in the first half of 1974 (The Guardian).

- According to the CBI, manufacturing output compares poorly internationally. In the 10 years to 1986 output has changed as follows:

UK	-3%
Japan	+56%
US	+34%
Germany	+18%
Italy	+15%
France	+5%

- The CBI Survey, however, indicates good prospects for manufacturing output. Their Survey asks firms whether their order book is above normal, normal, or below normal. For the past 8 months the balance on total orders has indicated a positive balance. On only one occasion between April 1977 and January 1987 was it positive. (CBI)

- The balance on the export order books has fallen from the record levels of June and July. Despite the disappointing trade figures, the August balance is still positive and has only been bettered on 5 other occasions since the question was first asked in its present form in April 1977 (CBI).

4. Manufacturing productivity

- Manufacturing productivity is up 7¼ per cent in the previous 12 months.

- It is up 38 per cent since 1979.

- Since 1980 productivity growth has been greater in the UK than in all major countries. The table below indicates the annual average percentage change in output per head in manufacturing.

Country	1960-70	1970-80	1980-86
UK	3.0	1.6	5.1
US	3.4	3.0	4.0
Japan	8.8	5.3	2.4
Germany	4.1	3.2	2.6
France*	4.8	3.0	2.7
Italy*	6.7	3.1	2.4
Canada	4.0	3.2	3.4
Major 7	6.1	2.9	3.3

* Whole industry, not just manufacturing

5. Average earnings

- Average earnings are up 8.25 per cent (underlying) in the 12 months to July 1987 (cf 7.75 per cent for whole economy and 4.4 per cent for inflation).

- Average earnings are up partly because settlements have not followed the inflation rate down, and partly because overtime is at its highest level since March 1980.

- Real earnings are up 21½ per cent since 1978-79.

6. Unit labour costs

- Unit labour costs have risen by a smaller percentage than average earnings due to productivity increases: 2.1 per cent between 1986Q1 and 1987Q1.

- Unit labour costs are, however, increasing more slowly than at the beginning of 1986.

- The change in unit labour costs in the UK does not compare favourably with that of the other major countries:

Country	%age Change 1986Q1-87Q1
UK	2.1
US	-1.1
Japan	-0.2
Germany	5.4
France	0.2
Italy	4.6
Canada	1.1
Major 7	0.7

- However, for the first time since 1983 unit labour costs in the UK are expected to rise no faster than in other major industrial nations.

7. Manufacturing employment

- In July 1987, 5,068,000 people were employed in manufacturing, 63,000 fewer than 12 months before (-1.2 per cent).

Mc

MARK CALL

3104/18

FROM: S J PICKFORD PW P

DATE: 25 SEPTEMBER 1987

MR S PRICE

cc PS/Chancellor
Sir T Burns
Mr Sedgwick
Mr Culpin o/r
Mr Davies
Mr Gilhooly
Miss O'Mara

RELEASE DATE OF RPI

Your minute of 16 September asked for comments on the DE proposal to move the release day of the RPI from Friday to Thursday.

2. Neither Mr Culpin nor I have strong feelings on this. From the presentational point of view there is little in practice to choose between the two.

3. Mr Gilhooly makes the point that it will on occasion coincide with the labour market statistics and could cause invidious comparisons between earnings and prices figures. But from the point of view of influencing wage bargainers, there may be occasions when we <u>want</u> to point up the relative movements in the two series. (One of the original purposes of moving the unemployment release date was precisely so that it would coincide with release of the earnings figures.)

4. His other point, that the release will occasionally coincide with first order questions, probably has more force. It could at times embarrass Treasury Ministers; but by the same token there may well be times when we will welcome a ready made platform to talk about the figures.

5. So from IDT's point of view we would not stand in the way of a move to Thursdays. However, it is probably worth checking with DE why they want to make the move. I vaguely recall that they made the change to Fridays many years ago precisely because they did not want the figures to appear in the weekday newspapers. But I am sure this argument would now have much less force.

Stephen Pickford

S J PICKFORD

From : D L C Peretz
Date : 28 September 1987

MR S PRICE

cc PS/Chancellor
Sir T Burns
Mr Sedgwick
Mr Davies
Mr Culpin
Mr Gilhooly
Miss O'Mara

RELEASE DATE OF RPI

Your minute of 22 September to Mr Culpin. I see no particular problem from the point of view of the financial markets with moving the RPI from Friday to Thursday. It means that one month in three it will coincide with publication of the BEQB : but I cannot see that that matters.

D L C PERETZ

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MR BATTISHILL
12/2
TREASURY

CSO(87)91

28 September 1987

INDUSTRIAL AND COMMERCIAL COMPANIES
SECOND QUARTER 1987

Appropriation account (Table A)

Provisional estimates suggest that, after deducting stock appreciation, profits of industrial and commercial companies in the second quarter of 1987 were little changed from their first quarter level.

In the latest quarter, North Sea oil companies' profits (net of stock appreciation and seasonally adjusted) were 40 per cent higher than at their low point in the second and third quarters of 1986. However their second quarter 1987 profits were still less than half the level of the peak in the fourth quarter of 1984.

The gross trading profits (net of stock appreciation) of non-North Sea industrial and commercial companies in the second quarter of 1987 were 13 per cent higher than in the corresponding quarter a year earlier. However, this comparison is distorted by British Gas and British Airways which are included in the industrial and commercial companies figures only since their privatisation on 3 December 1986 and 6 February 1987 respectively.

In the second quarter of 1987, payments of dividends on ordinary shares were below the very high level of the previous quarter. In the first half of 1987 these payments were 26 per cent higher than a year earlier. Between the second quarters of 1986 and 1987 payments of UK taxes on income rose by 3 per cent. Within this, payments of petroleum revenue tax by North Sea oil companies (net of refunds of advance petroleum revenue tax) fell by 56 per cent, whilst payments of other taxes rose by 31 per cent.

These preliminary estimates suggest that the broad measure of undistributed income (that is, before deducting stock appreciation or net unremitted profits from and due to related overseas concerns) of UK industrial and commercial companies in the second quarter of 1987 was over 40 per cent higher than a year earlier.

Capital account (Table B)

After deducting stock appreciation, the undistributed income of UK industrial and commercial companies is estimated to have risen by almost a third between the second quarters of 1986 and 1987. There was a corresponding increase in total receipts on their capital account.

Capital account spending rose by 5 per cent between the latest two quarters. In the second quarter of 1987 capital account spending was 18 per cent higher than a year earlier, mainly reflecting a 16 per cent increase in fixed capital formation. These movements on capital account resulted in an estimated £2¼ billion financial surplus for UK industrial and commercial companies in the second quarter of 1987.

Financial transactions (Table C)

The estimated £2¾ billion financial surplus of industrial and commercial companies in the second quarter of 1987 included £1 billion (net) of unremitted profits retained abroad. Borrowing from UK banks fell back by £1½ billion, whilst borrowing from other sources rose by £4¼ billion. The latter borrowing was dominated by over £4 billion of capital issues (net) in the UK and overseas.

Uses of these funds included investments of £1 billion in UK company securities, reflecting continued high cash expenditure on acquiring subsidiaries. There was also £3¼ billion of investment abroad in the second quarter of 1987 and a flow of £3 billion into liquid assets.

A major component of the "other financial assets" total for the second quarter will not be available until December (see Note 4 to Editors), so it is not possible to estimate the net borrowing requirement of UK industrial and commercial companies in the second quarter of 1987 until then. The net borrowing requirement of UK industrial and commercial companies in the first quarter of 1987 amounted to £1¾ billion.

Interpretation of the industrial and commercial companies data continues to be hampered by the size and variability of the unexplained flows (balancing item), which reflect errors and omissions in the measurement of components of the appropriation, capital and financial transactions accounts. Investigation of the causes of the unexplained flows is continuing.

NOTES TO EDITORS

1. The figures given in this press notice are consistent with the annual data in the 1987 edition of the United Kingdom National Accounts 'The CSO Blue Book' published on 4 September. They therefore incorporate revisions (as a result of the use of more recent annual data and the introduction of improvements in methodology) since the last set of quarterly figures were published on 29 June. The table below summarises the revisions to the annual figures in Tables A and B since the June press notice was issued.

Differences between estimates contained in this press notice and those published on 29 June 1987

A. Appropriation Account £ billion

	1980	1981	1982	1983	1984	1985	1986
Total income	-	0.5	1.2	1.2	0.1	0.9	1.5
Gross trading profits:							
N Sea oil companies	-	-	-	-	-	-	-
Other companies	-0.2	-0.2	0.3	-	-1.2	-0.9	-0.1
Stock appreciation	-0.2	-	-	-	-	-	-
Rent and non-trading income	0.4	0.7	0.9	1.2	1.4	1.9	2.1
Income from abroad	-	-	-	-	-0.1	-0.1	-0.4
Total allocation of income	-0.3	-0.2	-	-0.1	-0.6	-1.0	-0.5
Dividends on ordinary shares	0.1	0.1	0.2	0.2	-0.2	-0.4	0.2
Other dividends and interest	-0.3	-0.2	-0.3	-0.4	-0.6	-0.4	-0.5
Profits due abroad	-	-	-	-	-	-	0.2
UK taxes on income	-0.1	-	0.1	0.1	0.2	-0.1	-0.3
Undistributed income	0.4	0.7	1.2	1.3	0.6	1.9	2.0

B Capital account

	1980	1981	1982	1983	1984	1985	1986
Total receipts	0.4	0.7	1.2	1.3	0.6	1.9	2.0
Gross domestic fixed capital formation	-0.2	-0.2	-0.2	-0.3	-0.1	1.1	1.0
Value of physical increase in stocks	-	-	-	-	0.4	0.1	-0.1
Financial surplus/deficit	0.6	0.9	1.4	1.6	0.3	0.7	1.1

The changes which have affected the definitions of industrial and commercial companies' appropriation account receipts and expenditure are described on page 120 of the 1987 edtion of the CSO Blue Book; those to fixed capital formation and stocks are described on page 125.

2. The figures in Table B of this press notice include an allowance for some misreporting of stocks discovered since publication of the gross domestic product (GDP) press notice on 21 September. The Business Statistics Office are investigating and will be publishing revised stockbuilding estimates in due course. Revised GDP figures are available via the CSO Databank (see Note 6 to Editors).

3. This press notice includes the full capital account and partial financial transactions account as well as the appropriation account of industrial and commercial companies. Prior to the fourth quarter 1985 press release, the capital account and financial transactions estimates were published about three weeks later than the appropriation account.

4. Second quarter 1987 data on deposits with and borrowing from banks in the reporting area covered by the Bank for International Settlements (BIS) are not yet available. This item is a significant part of the "other financial assets" component of the industrial and commercial companies' net borrowing requirement in Table C. Thus neither the net borrowing requirement nor the balancing item are available at present for the latest quarter. For the second quarter of 1987, these figures are expected to appear first in Table 8.3 of the December 1987 issue of Financial Statistics.

5. Tables A and C of this press notice appear in Tables 8.1 and 8.3 of Financial Statistics. Table B appears in summary form in Financial Statistics Table 1.2. All three tables appear in full on pages 60 and 62 of Economic Trends.

6. As usual, the commentary in the press notice is based entirely on seasonally adjusted data, as shown in the attached tables. An obelus indicates that the data are new or have been revised. The period so marked is the earliest in the column to have been revised. If the obelus appears against the first figure in a column, this implies that earlier data have also probably been revised. Figures for these earlier periods can be obtained via the CSO Databank. The Databank is a collection of macro-economic time-series sold to the public in computer-readable form. Details of the service offered and the schedule of charges may be obtained from the Databank Manager, CSO Branch 9, Room 52A/4, Government Offices, Great George Street, London SW1P 3AQ (Telephone: 01-270 6386 or 6387). CSO does not offer direct on-line access for these data, but a list of host bureaux offering such a facility is available on request from CSO.

APPROPRIATION ACCOUNT OF INDUSTRIAL AND COMMERCIAL COMPANIES (1)

Seasonally adjusted

TABLE A £ MILLION

		Income								Allocation of income					Balance	
			Income arising in the United Kingdom													
			Gross trading profits								Dividends and interest, etc payments(3)					
			Net of stock appreciation													
		Total income	Total(2)	N.Sea oil companies	Other companies	Stock appreciation	Before deducting stock appreciation	Rent and non-trading income	Income from abroad (net of taxes paid abroad)	Total allocation of income	Dividends on ordinary shares	Other(4)	Profits due abroad net of UK tax	UK taxes on income (payments)(5)	Undistributed income	Undistributed income adjusted for unremitted profits
		AIAN	AIAO	CIDT	CIDU	AIAP	AIAQ	AIAR	AIAS	CIHL	AIAU	AIAV	AIAW	AIAY	AAUQ	AIAZ
1980		40,033†	26,090†	8,056	18,034†	5,364†	31,454†	3,607†	4,972	22,202†	3,231†	8,842†	4,424	5,705†	17,831†	18,590†
1981		43,109	28,470	10,864	17,606	5,005	33,475	4,206	5,428	23,958	3,261	8,860	4,182	7,655	19,151	18,871
1982		46,616	33,512	12,726†	20,786	3,460	36,972	4,418	5,226†	26,783	3,837	9,751	3,973†	9,222	19,833	19,294
1983		55,660	40,241	15,683	24,558	4,131	44,372	4,783	6,505	29,627	4,582	9,591	4,631	10,823	26,033	25,086
1984		66,428	47,799	19,008	28,791	4,555	52,354	5,420	8,654	34,480	5,139	10,994	5,536	12,811	31,948	29,347
1985		75,617	57,154	18,359	38,795	2,584	59,738	6,892	8,987	41,602	6,379	13,751	6,354	15,118	34,015	32,749
1986		72,585	55,573	8,387	47,186	1,899	57,472	7,318	7,796	38,386	8,708	12,373	4,825	12,480	34,200	32,757
1984	1	15,490†	11,037†	4,189†	6,848†	1,002†	12,039†	1,312†	2,139†	8,147†	1,130†	2,387†	1,631†	2,999†	7,343†	7,181†
	2	15,826	11,434	4,651	6,783	1,350	12,784	1,241	1,801	8,294	1,352	2,602	1,344	2,996	7,532	7,261
	3	17,288	12,419	4,920	7,499	976	13,395	1,442	2,451	8,753	1,216	3,052	1,239	3,246	8,535	7,895
	4	17,824	12,909	5,248	7,661	1,227	14,136	1,425	2,263	9,286	1,441	2,953	1,322	3,570	8,538	7,010
1985	1	19,660	13,935	5,111	8,824	1,276	15,211	1,747	2,702	10,914	1,341	3,675	2,069	3,829	8,746	8,543
	2	19,176	14,689	4,925	9,764	407	15,096	1,750	2,330	10,141	1,491	3,511	1,521	3,618	9,035	8,545
	3	18,492	14,064	4,124	9,940	488	14,552	1,678	2,262	10,056	1,805	3,248	1,124	3,879	8,436	8,007
	4	18,289	14,466	4,199	10,267	413	14,879	1,717	1,693	10,491	1,742	3,317	1,640	3,792	7,798	7,654
1986	1	17,687	14,508	3,107	11,401	-374	14,134	1,848	1,705	10,044	2,082	3,201	1,279	3,482	7,643	7,605
	2	17,265	13,331	1,666	11,665	384	13,715	1,751	1,799	9,486	2,184	2,862	1,072	3,368	7,779	7,671
	3	18,454	13,898	1,641	12,257	638	14,536	1,756	2,162	8,319	2,059	2,972	1,031	2,257	10,135	9,844
	4	19,180	13,836	1,973	11,863	1,251	15,087	1,963	2,130	10,537	2,383	3,338	1,443	3,373	8,643	7,637
1987	1	20,680	15,227	2,373	12,854	791	16,018	2,030	2,632	10,689	2,955	3,250	1.638	2,846	9,991	9,091
	2	21,049	15,500	2,312	13,188	1,204	16,704	1,815	2,530	10,064	2,417	3,082	1,100	3,465	10,985	10,040

(1) Figures reflect privatisation of British Telecom with effect from 28 November 1984, British Gas from 3 December 1986 and British Airways from 6 February 1987.
(2) Before providing for depreciation.
(3) Dividend payments on ordinary and preference shares are net of tax; the advance corporation tax in respect of such payments is included in "UK taxes on income". Excludes dividends and debenture interest paid by UK subsidiaries to their overseas parents.
(4) Includes royalties and licence fees on oil and gas production.
(5) Includes payments of corporation tax (including advance corporation tax) and petroleum revenue tax.

An obelus in the table indicates that the data are new or have been revised. The period marked is the earliest in the table to have been revised.

CAPITAL ACCOUNT AND FINANCIAL SURPLUS/DEFICIT OF INDUSTRIAL AND COMMERCIAL COMPANIES(1)

Seasonally adjusted

TABLE B £ MILLION

	Receipts	Undistributed income(3)				Expenditure				
	Total(2)	Including stock appreciation	Stock appreciation	After deducting stock appreciation	Capital transfers	Total	Gross domestic fixed capital formation	Value of physical increase in stocks and work in progress	Taxes on capital and other capital transfers	Balance: Financial surplus/deficit
	FMBA	AAUQ	AIAP	FMBC	CIDZ	FMBF	AAUS	FMBG	FMBH	AAVG
1980	12,988†	17,831†	5,364†	12,467†	521	12,366†	14,893†	-2,622†	95	622†
1981	14,893	19,151	5,005	14,146	747	12,283	14,716	-2,532	99	2,610
1982	17,051	19,833	3,460	16,373	678	13,666	15,293	-1,672	45	3,385
1983	22,566	26,033	4,131	21,902	664	15,787	15,476	131	180	6,779
1984	27,937	31,948	4,555	27,393	544	20,278	19,353	727	198	7,659
1985	31,989	34,015	2,584	31,431	558	24,681	24,539	-26	168	7,308
1986	32,998	34,200	1,899	32,301	697	26,559	25,992	405	162†	6,439
1984 1	6,479†	7,343†	1,002†	6,341†	138†	4,775†	4,359†	361†	55	1,704†
2	6,316	7,532	1,350	6,182	134	4,584	4,777	-237	44	1,732
3	7,704	8,535	976	7,559	145	5,046	4,877	119	50	2,658
4	7,438	8,538	1,227	7,311	127	5,873	5,340	484	49	1,565
1985 1	7,648	8,746	1,276	7,470	178	5,805	6,085	-329	49	1,843
2	8,720	9,035	407	8,628	92	6,369	5,978	352	39	2,351
3	8,089	8,436	488	7,948	141	6,282	6,233	9	40	1,807
4	7,532	7,798	413	7,385	147	6,225	6,243	-58	40	1,307
1986 1	8,164	7,643	-374	8,017	147	6,551	6,263	243	45†	1,613
2	7,605	7,779	384	7,395	210	6,061	6,220	-199	40	1,544
3	9,681	10,135	638	9,497	184	6,645	6,792	-188	41	3,036
4	7,548	8,643	1,251	7,392	156	7,302	6,717	549	36	246
1987 1	9,360	9,991	791	9,200	160	6,789	6,694	56	39	2,571
2	9,904	10,985	1,204	9,781	123	7,154	7,214	-100	40	2,750

(1) Figures reflect privatisation of British Telecom with effect from 28 November 1984, British Gas from 3 December 1986 and British Airways from 6 February 1987.
(2) After deducting stock appreciation but before providing for depreciation.
(3) Equals profits and other incomes after deduction of taxes on income, payments of dividends and interest etc and profits due abroad.

An obelus in the table indicates that the data are new or have been revised. The period marked is the earliest in the table to have been revised.

TABLE C

FINANCIAL TRANSACTIONS INCLUDING NET BORROWING REQUIREMENT OF INDUSTRIAL AND COMMERCIAL COMPANIES(1)

Seasonally adjusted

£ MILLION

	Transactions leading to net borrowing requirement(NBR)						Financing of NBR(5)				
							Borrowing from		Financial assets		
	Financial surplus/ deficit	Net unremitted profits(2)	Net identified trade and other credit(3)	Investment in UK company securities(4)	Investment abroad	Balancing item	Banks(6)	Other	Liquid	Other(7)	Net borrowing requirement (NBR)
	1	2	3	4	5	6	7	8	9	10	11
	AAVG	AICX	ABKP	AICC	AIDC	AIDD	AIDF	AIDJ	AIDG	AICV	AIDI
1980	622†	759	-210†	-1,189†	-3,108†	-2,783†	6,340	3,522†	-3,615	-338†	5,909†
1981	2,610	-280	1,448	-1,286	-4,024	-2,731	5,848	4,155	-4,694	-1,046	4,263
1982	3,385	-539	-1,107	-676	-2,927	-3,685	6,562	3,272	-2,801	-1,484	5,549
1983	6,779	-947	756	706	-3,525	-2,643	1,618	4,845	-5,862†	-1,727	-1,126
1984	7,659	-2,601	-4	-3,330	-1,560	-2,795	7,075	-596	-2,205	-1,643	2,631
1985	7,308	-1,266	-315	-1,249	-4,426	-7,512	7,329	5,544	-4,972	-441	7,460
1986	6,439	-1,443†	-410	-1,190	-5,356	-4,204	5,329	11,237	-11,499	1,097	6,164
1984 1	1,704†	-162†	793†	-1,211†	-839†	-1,064†	873	681†	-820†	45†	779†
2	1,732	-271	-432	-670	-29	189	1,063	-3,038	1,391	65	-519
3	2,658	-640	-6	-333	-321	-1,866	1,466	1,025	-1,028	-955	508
4	1,565	-1,528	-349	-1,116	-371	-356	3,673	736	-1,456	-798	2,155
1985 1	1,843	-203	885	-393	-1,935	-1,702	1,657	2,402	-1,836	-718	1,505
2	2,351	-490	-1,091	-564	-932	-2,547	1,603	1,040	-471	1,101	3,273
3	1,807	-429	425	-247	-705	-570	2,074	1,031	-1,812	-1,574	-281
4	1,307	-144	-548	-45	-854	-2,693	1,995	1,071	-839	750	2,977
1986 1	1,613	-38	1,610	-130	246	-3,075	811	1,700	-2,212	-525	-226
2	1,544	-108	-925	-461	-516	-50	-175	3,701	-3,983	973	516
3	3,036	-291	-736	-380	-2,334	2,107	-515	2,563	-5,767	2,317	-1,402
4	246	-1,006	-345	-219	-2,752	-3,088	4,881	3,175	776	-1,668	7,164
1987 1	2,571	-900	1,148	-341	-911	-3,220	1,910†	2,154	-1,624	-787	1,653
2	2,750	-945	-764	-946	-3,140	..	-1,578	4,200	-3,070	..	..

(1) Inflows(+), outflows(-); Relationships between columns: (1+2+3+4+5)+6+(7+8+9+10)=zero; 7+8+9+10=11
(2) Retained in UK (+),retained abroad(-).
(3) Includes accruals adjustment.
(4) Cash expenditure on subsidiaries and trade investments in the UK.
(5) The NBR seasonal adjustments include day-of-week adjustments; the quarterly figures therefore do not always sum to the annual totals.
(6) Includes Bank of England Issue Department transactions in commercial bills.
(7) Not yet available for the most recent quarter.

An obelus in the table indicates that the data are new or have been revised. The period marked is the earliest in the table to have been revised.

29 SEP 1987

ECONOMIC SECRETARY
REC'D 29 SEP 1987
ACTION CST
COPIES TO

CHIEF SECRETARY
REC. 29 SEP 1987
ACTION Mr Instone
COPIES TO CX Mr Butler Mr Anson
Mr Hawtin Mr Edwards
Mr Call

28 September 1987

Lord Belstead
Minister of State for the
Environment, Countryside and Water
Department of the Environment
2 Marsham Street
LONDON SW1P 3EB

REPORT OF THE WORLD COMMISSION ON ENVIRONMENT AND DEVELOPMENT (WCED): DEBATE IN THE UN GENERAL ASSEMBLY

Thank you very much for a copy of your letter of 17 September to Lord Glenarthur setting out your proposals for the handling of the Brundtland Report in the UN General Assembly. I apologise for the delay in replying, but I have been in Mexico and Belize for the last week.

As you say, our intervention will represent the first detailed government response to the Report. I understand that it has now been decided that the Report will be debated in the plenary session and that Mrs Brundtland herself will take part. Our intervention will, therefore, attract considerable attention both internationally and domestically.

I am seeing a group of environmental NGOs on 1 October and I expect that they will call for a formal government response to the report and for an initiative to give the Report some momentum internationally. We cannot take all this on board for the General Assembly debate, but we can I think make a very positive presentation of our views. I should like to see a rather fuller response than the present draft intervention, including a longer passage on development issues reflecting our more recent thinking. It may also need to be recast now that it is to be delivered in plenary. As the debate does not start until 19 October, our officials have time to look at the draft again and I suggest that you should instruct them to do so.

I understand that you are not planning to attend the debate and that your Department would be content for Crispin Tickell to make our intervention. I am sure that he would do so admirably.

/However well

However well manicured our intervention in the General Assembly may be, we cannot, of course, deal with all the issues in a 15 minute intervention. I wonder whether, looking a little further ahead, you have given any thought to publishing a response to the Brundtland Report. You have a model in your excellent "Conservation and Development - the British Approach", which was prepared as a response to the World Conservation Strategy. I would be happy for ODA to make an appropriate contribution on the developmental aspects. I am copying this letter to Lord Glenarthur, Kenneth Clarke, Peter Lilley, Peter Morrison and Jean Trumpington.

CHRIS PATTEN

FROM: S P JUDGE
DATE: 29 September 1987

MR CALL

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Cropper
Mr Tyrie

MANUFACTURING INDUSTRY

The Paymaster General has seen your note of 25 September to the Chief Secretary.

He was surprised by the 0.2 per cent reduction in Japanese unit labour costs between 1986 Q1 and 1987 Q1.* He recalls asking about this earlier (papers attached), but these figures are for a slightly earlier period (3.9 per cent increase in the year to 1986 Q3).

The Paymaster would like to see a manufacturing productivity league table, using Japan or Germany or US as 100, and covering the period in your paragraph 4.

S P JUDGE
Private Secretary

*(your paragraph 6).

td21 ff 7 APR 1987 -26

M S

Most grateful
PB 7/iv

FROM: A M DOLPHIN
DATE: 7 April 1987

MR JUDGE

cc Mr Colenutt

WORLD ECONOMIC DEVELOPMENTS

Your minute of 3 April recorded the Minister's interest in developments in unit labour costs in Japan and Germany.

2. The attached table is designed to show why, in both countries, the growth in unit labour costs was higher in 1986Q3 than one year earlier. The table shows growth rates of the components of unit labour costs: compensation, output etc.

3. The second and third rows of the table show that part of the explanation for the acceleration of unit labour costs in Germany is a pick up in the growth of hourly compensation. In Japan on the other hand faster unit labour cost growth is wholly attributable to a slowdown in the growth of output per manhour.

4. In both Germany and Japan output growth has slowed considerably since 1985, partly because of the large appreciation of the yen and D-Mark. This slowdown in growth has not been fully reflected in hours worked, though employment growth has slowed in Japan and in both Germany and Japan average hours worked per man fell markedly in the year to 1986Q3.

5. In summary, therefore, it is true to say that in both Japan and Germany the growth of unit labour costs has picked up because employment/hours worked have not fully adjusted to a slowdown in output growth. In Germany, this has been exacerbated by an acceleration in hourly compensation.

A. M. Dolphin

A M DOLPHIN

Unit labour costs in Germany and Japan

percentage change from year earlier

(a) = (b) - (c)
(c) = (d) - (e)

	Germany		Japan	
	1986Q3	1985Q3	1986Q3	1985Q3
Unit labour cost (a)	4.7	1.6	3.9	1.1
equals				
Hourly compensation (b)	5.6	4.1	4.0	4.1
minus				
Output per manhour (c)	0.8	2.4	0.1	3.0
equals				
Output (d)	1.8	4.7	-1.1	4.3
minus				
Manhours (e)	0.9	2.2	-1.2	1.3
equals				
Employment (f)	1.8	2.2	0.3	1.5
plus				
Average hours (g)	-0.9	0.1	-1.5	-0.2

$e = f + g$

Note: Figures may not always add or subtract as shown due to errors in rounding.

1236/45

FROM: MARK CALL
DATE: 29 SEPTEMBER 1987

MR J COLENUTT, IF2

cc PS/Chancellor C 12/2)
PS/Chief Secretary)
PS/Financial Secretary)
PS/Paymaster General)
PS/Economic Secretary) w/o
Mr Cropper) att
Mr Tyrie)

MANUFACTURING INDUSTRY

I write to you as contact point for Section X of the TWEB: World Economic Developments etc. In the attached minute from Mr Judge, dated 29 September, you will see that the Paymaster General would like to know the cause of the turnround in Japanese manufacturing unit labour costs. The latest TWEB indicates that between 1986Q1 and 1987Q1 unit labour costs in Japan decreased 0.2 per cent, compared with an increase of 3.9 per cent in the year to 1986Q3, a figure indicated in previous correspondence with the Paymaster General. It would be enlightening to see how the calculation laid out in the table attached to Mr Dolphin's note of 7 April produces the -0.2 per cent figure.

2. You will note that the Paymaster General would also be interested to see a manufacturing productivity league table, using either Japan, Germany or the US as an index of 100, and covering the period 1960 to date. A table layout as in paragraph 4 of my note of 25 September would be helpful.

Mc

MARK CALL

ENC

SF/H61

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David Norgrove Esq
Private Secretary
10 Downing Street
LONDON
SW1A 2AA

30 September 1987

Dear David

OUTLOOK FOR RPI

I enclose a copy of the usual monthly brief on the Retail Price Index outlook for September and October 1987.

Copies of this go to Alex Allen (Treasury), Sir Peter Middleton (Treasury), Timothy Walker (Trade and Industry), Ms A Large (CSO), John Footman (Bank of England), Chris Cloke (Cabinet Office) and Sir Brian Hayes (Trade and Industry).

Yours sincerely
John Turner

JOHN TURNER
Principal Private Secretary

2

PERSONAL AND CONFIDENTIAL

OUTLOOK FOR RETAIL PRICES: SEPTEMBER AND OCTOBER

1. As anticipated the annual rate of inflation seems set to show a decline for September. The 12-month change in the retail prices index is expected to fall to around 4¼ per cent compared with the 4.4 per cent for August.

2. Between August and September prices are expected to have risen by about ⅓ per cent; a rise of 0.5 per cent was recorded between the corresponding months last year, when there was a sharp increase in petrol prices. For this September a significant rise in the price of clothing is expected with the end of the summer sales and the arrival of the new season's stocks. Beer, household goods and motor vehicles are also expected to have risen in price. A further fall in the price of seasonal foods is expected.

3. The figure for the percentage change in the index in the 12 months to September is of particular importance because it will be used in the calculations to uprate state pensions and benefits next April.

4. For October the annual rate of inflation is expected to increase slightly into the 4¼-4½ per cent range before dropping again in November. There is likely to be an increase of around ⅓ per cent in the overall level of prices between September and October compared with the increase of 0.2 per cent recorded between the corresponding months last year.

Percentage change in the RPI

	12 months	over 1 month	
	all items	all items	all excluding seasonal food
June	4.2	0.0	0.1
July	4.4	-0.1	0.1
Aug	4.4	0.3	0.3
FORECASTS			
September	4¼	⅓	¼
October	4¼-4½	⅓	⅓

SEPTEMBER 1987

NP

FROM: P H BROOK
DATE: 2 October 1987

1. MR KELLY cwk 2.10.
2. ECONOMIC SECRETARY

cc: Chancellor
Sir P Middleton
Sir T Burns
Sir G Littler
Mr Cassell
Mr Peretz
Mr Sedgwick
Mr Culpin
Mr Grice
Miss Noble
Mr Hall

DTI PRESS NOTICE ON CONSUMER CREDIT
(All figures are seasonally adjusted)

From August the coverage and presentation of the monthly DTI press notice on credit business statistics changed. Following these changes we agreed to circulate the press notice in advance of publication each month; highlighting any particular points of note. I attach the DTI press notice on credit business in August that will be published at 11.30am on Monday 5 October.

2. There is little of note in the figures. The main change to the coverage of the new style press notice is the inclusion of quarterly data on personal loans and overdrafts not exceeding £15,000. Data for Q3 will not, however, be available until next month. Monthly data is available for consumer credit advanced by, and amounts outstanding to, retailers and finance houses etc, and on bank credit cards (tables 1 and 3). Table 1 shows that in August consumer credit outstanding in these categories increased by £215 million (1 per cent) the lowest increase this year. The increase in the amount outstanding in the last 3 months was £790 million (3.8 per cent) compared with £1,103 million (5.5 per cent) in the 3 months to May. The annual growth rate of credit outstanding fell to 18 per cent to August from 18.2 per cent to July.

3. There is nothing in the figures that necessitates any revision to the briefing lines on consumer credit included in the briefing for the August money supply figures. This was agreed by the Chancellor and circulated under cover of my minute of 25 September to Mr Cassell. If, as seems unlikely, publication of the DTI press notice elicits any questions to the Treasury press office about consumer credit/monetary policy, I suggest that IDT draw upon this.

P H BROOK

CONFIDENTIAL
UNTIL 11.30 HOURS
ON DAY OF RELEASE

DTI Press Notice

Department of Trade and Industry
1 Victoria Street SW1H 0ET
Press Office: 01-215 4471/4475
Out of hours: 01-215 7877

Number 87/581
5 October 1987

CREDIT BUSINESS IN AUGUST

During August the **change in amounts outstanding on consumer credit agreements** with finance houses, other specialist credit grantors, building societies, retailers and on bank credit cards was £0.2 billion (see **Table 1**), a similar increase to that recorded in July.

The increase in the latest three months, June to August, was £0.8 billion, below the corresponding figure of £1.1 billion in the previous three months. Within the total, the increase shown by finance houses, other specialist credit grantors and building societies was £0.5 billion in the most recent period compared with £0.8 billion in the previous one. Bank credit cards showed an increase of £0.2 billion in the latest three months, less than the increase of £0.3 billion in the previous period. The increase for retailers was £0.1 billion in both three month periods.

New credit advanced to consumers in August by finance houses, other specialist credit grantors, building societies, retailers and on bank credit cards amounted to £3.0 billion, compared with a total of £2.9 billion in July (see Table 3). The total for the three months June to August was 7 per cent higher than that for the previous three months.

In August there was a **change in amounts outstanding on agreements with businesses** by finance houses, other specialist credit grantors and building societies of £0.1 billion (see **Table 1**). The total change in the latest three months was £0.4 billion compared with a change of £0.2 billion in the preceding three months.

NOTES TO EDITORS

1 All figures are quoted after seasonal adjustment. The seasonal adjustments of bank loans on personal account and of credit card lending are subject to greater uncertainty than the seasonal adjustments of the other data owing to the shortness of the series.

2 **Table 1** covers amounts outstanding and changes in amounts outstanding to finance houses, other specialist credit grantors and building societies, retailers and on bank credit cards. Loans by retailers and on bank credit cards are mainly to consumers and are treated as consumer agreements. Loans by finance houses, other specialist credit grantors and building societies, are split into agreements with consumers and agreements with businesses and the two components are shown separately.

3 **Table 2** includes the same data as Table 1 on agreements with consumers. Also shown are figures for loans by banks (monetary sector institutions other than those included in finance houses and other specialist credit grantors) on personal accounts, where the amount outstanding does not exceed £15,000, and by insurance companies to individuals, excluding loans for house purchase and bridging finance. These figures are available only quarterly. This table covers all institutions providing finance for consumers and thus provides a quarterly series for total consumer credit.

4 **Table 3** shows new credit advanced by finance houses, other specialist credit grantors and building societies, retailers and on bank credit cards. The coverage is the same as for Table 1 except that dealer stock funding loans by finance houses to businesses are excluded. A high proportion of credit advances in certain types of agreements, notably on bank credit cards and by mail order houses, is repaid within a month, reflecting the use of such agreements as a method of payment rather than as a means of obtaining credit.

5 Unsecured loans by building societies, which are advanced under the terms of the Building Societies Act 1986, are included from January 1987. Amount outstanding on bank loans on personal accounts are available from end December 1986 only. Lending by finance houses and other specialist credit grantors where the group specialises in lending to other companies only are excluded from the statistics in this Press Notice.

6 Further definitions are given at the foot of the tables accompanying this Press Notice.

7 Full results of the inquiries which collect the monthly information on credit are published by H M Stationery Office in Business Monitor SDM6 - Credit business. This may be obtained on subscription (£17.50 per annum) from H M Stationery Office P O Box 569, London SE1 9NH. Individual copies are available, price £3.20 each from:

The Library,
Business Statistics Office,
Government Buildings,
Cardiff Road,
Newport, GWENT.
Telephone: Newport (0633) 222973.

8 Non-press calls to 01-215 3138

TABLE 1

CHANGES IN AMOUNTS OUTSTANDING TO FINANCE HOUSES, OTHER SPECIALIST CREDIT GRANTORS AND BUILDING SOCIETIES, RETAILERS AND ON BANK CREDIT CARDS. (SEASONALLY ADJUSTED)

£ Million

	AGREEMENTS WITH CONSUMERS				AGREEMENTS WITH BUSINESSES	TOTAL AGREEMENTS
	TOTAL	RETAILERS (a)	BANK CREDIT CARDS	FINANCE HOUSES, OTHER SPECIALIST CREDIT GRANTORS AND BUILDING SOCIETIES ON AGREEMENTS WITH CONSUMERS	BUSINESSES	
	A=B+C+D	B	C	D	E	A+E
AMOUNTS OUTSTANDING AT END OF PERIOD						
1986	19,063	2,231	4,681	12,151	5,728	24,791
1987 JUL	21,294R	2,406R	5,292	13,596R	6,255	27,549R
AUG	21,509	2,431	5,212	13,866	6,357	27,866
CHANGES IN AMOUNTS OUTSTANDING (b)						
1986	2,437	94	891	1,452	596	3,033
1986 1st Qtr	855	39	221	595	214	1,069
2nd Qtr	346	3	213	130	34	380
3rd Qtr	792	107	356	329	193	985
4th Qtr	444	-55	101	398	155	599
1987 1st Qtr	952	67	248	637	5	957
2nd Qtr	1,038R	56	260	722R	373	1,411R
1986 AUG	217	34	82	101	48	265
SEP	392	45	194	153	72	464
OCT	194	-81	86	189	127	321
NOV	-15	12	-113	86	-23	-38
DEC	265	14	128	123	51	316
1987 JAN	257	8	15	234	-17	240
FEB	296	27	97	172	24	320
MAR	399	32	136	231	-2	397
APR	410	20	113	277	66	476
MAY	294	20	19	255	141	435
JUN	334R	16	128	190R	166	500R
JUL	241R	52R	103	86R	149	390R
AUG	215	25	-80	270	102	317
1987 MAR-MAY	1,103	72	268	763	205	1,308
JUN-AUG	790	93	151	546	417	1,207

R = revised

NOTES

(a) Self financed credit advanced by clothing retailers, household goods retailers, mixed retail businesses (other than Co-operative societies) and general mail order houses only.

(b) Data were not collected on a consistent basis for all types of credit grantor prior to 1986. The following table gives figures for changes in amounts outstanding which are available:

£ Million

	1983	1984	1985
Retailers	132	116	195
Finance Houses etc.	2,286	2,180	2,541

TABLE 2

CHANGES IN AMOUNTS OUTSTANDING ON ALL CONSUMER CREDIT AGREEMENTS.

(SEASONALLY ADJUSTED)

£ Million

CONSUMER CREDIT AGREEMENTS

	TOTAL (a)	RETAILERS (b)	BANKS (c)		INSURANCE COMPANIES	FINANCE HOUSES, OTHER SPECIALIST CREDIT GRANTORS AND BUILDING SOCIETIES
			CREDIT CARDS	LOANS ON PERSONAL ACCOUNTS (d)		
AMOUNT OUTSTANDING AT END OF PERIOD						
1986	31,095	2,231	4,681	11,228	804	12,151
1987 1st Qtr	32,267	2,298	4,929	11,440	812	12,788
2nd Qtr	33,730R	2,354	5,189	11,895	782R	13,510R
CHANGES IN AMOUNTS OUTSTANDING						
1986	2,496	94	891		59	1,452
1986 1st Qtr	858	39	221		3	595
2nd Qtr	360	3	213		14	130
3rd Qtr	806	107	356		14	329
4th Qtr	472	-55	101		28	398
1987 1st Qtr	1,172	67	248	212	8	637
2nd Qtr	1,463R	56	260	455	-30R	722R

—— indicates a break in the series

R = revised
E = estimated

NOTES

(a) Changes in amounts outstanding in 1986 exclude bank loans on personal accounts.

(b) Self-financed advances by clothing retailers, household goods retailers mixed retail businesses (other than Co-operative societies) and general mail order houses only.

(c) Monetary sector institutions other than those included in finance houses and other specialist credit grantors.

(d) Amounts outstanding on bank loans on personal accounts, not exceeding £15,000, excluding bridging loans and house purchase finance.

TABLE 3

NEW CREDIT ADVANCED BY FINANCE HOUSES, OTHER SPECIALIST CREDIT GRANTORS AND BUILDING SOCIETIES, RETAILERS AND ON BANK CREDIT CARDS. (SEASONALLY ADJUSTED)

£ Million

	AGREEMENTS WITH CONSUMERS				AGREEMENTS WITH BUSINESSES	TOTAL AGREEMENTS
	TOTAL	RETAILERS (a)	BANK CREDIT CARDS	FINANCE HOUSES, OTHER SPECIALIST CREDIT GRANTORS AND BUILDING SOCIETIES ON AGREEMENTS WITH		
				CONSUMERS	BUSINESSES (b)	
1986	28,026	4,834	12,916	10,276	3,489	31,515
1986 1st Qtr	6,549	1,146	2,926	2,477	826	7,375
2nd Qtr	6,875	1,191	3,115	2,569	864	7,739
3rd Qtr	7,349	1,267	3,395	2,687	874	8,223
4th Qtr	7,253	1,230	3,480	2,543	925	8,178
1987 1st Qtr	7,918	1,241	3,874	2,803	963	8,881
2nd Qtr	8,440	1,272	3,997	3,171	1,029	9,469
986 AUG	2,383	421	1,068	894	285	2,668
SEP	2,555	431	1,220	904	315	2,870
OCT	2,437	413	1,152	872	322	2,759
NOV	2,360	420	1,129	811	275	2,635
DEC	2,456	397	1,199	860	328	2,784
1987 JAN	2,417	411	1,177	829	278	2,695
FEB	2,618	415	1,276	927	331	2,949
MAR	2,883	415	1,421	1,047	354	3,237
APR	2,766	416	1,289	1,061	314	3,080
MAY	2,697	414	1,268	1,015	335	3,032
JUN	2,977	442	1,440	1,095	380	3,357
JUL	2,944R	447R	1,410	1,087R	359	3,303R
AUG	3,002	457	1,384	1,161	354	3,356
1987 MAR-MAY	8,346	1,245	3,978	3,123	1,003	9,349
JUN-AUG	8,923	1,346	4,234	3,343	1,093	10,016
Percentage increase over previous three months	7	8	6	7	9	7

R = revised

NOTES

(a) Self financed credit advanced by clothing retailers, household goods retailers, mixed retail businesses (other than Co-operative societies) and general mail-order houses only.

(b) Excluding dealer stock funding. These agreements are included in tables 1 and 2.

CONFIDENTIAL

FROM: S J DAVIES
DATE: 2 OCTOBER 1987

CHANCELLOR OF THE EXCHEQUER

cc : Chief Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Kemp
Mr Monck
Mr Burgner
Mr H P Evans
Mr Gilmore
Mr Mountfield
Mr Odling-Smee
Miss Peirson
Mr Peretz
Mr Robson
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mrs R Butler
Mr Gieve
Mr Gilhooly
Mr Gray
Mr McIntyre
Mr Mowl
Mr Allum
Mr Cunningham
Mr Call
Mr Cropper
Mr Tyrie

Ch

Not for decision now, but in line with what Terry was telling you.

AA

ECONOMIC ASSUMPTIONS FOR PUBLIC EXPENDITURE

Following my submission of 18 September you agreed the unemployment and earnings assumptions for the 1987 Public Expenditure White Paper, and an assumption to be used for the 1988 Social Security uprating pending the publication of the relevant outturn RPI figure in mid October.

2. This second submission covers the remaining economic assumptions affecting public expenditure that are to be published in the Autumn Statement and the Public Expenditure White Paper (ie those for the RPI and the GDP deflator); and also covers unpublished figures for interest rates. (Table 3 of the Annex sets out when and where the various assumptions are published.)

EcAssp
ch-2oct

3. The normal timetable requires these revised assumptions to be worked into the paper for the Star Chamber in the week beginning 5th October, before the autumn forecast is finalised. However, this year, with the Star Chamber working to a more flexible target than in the past - "as close as possible to the planning totals" - and in particular with their not having to consider social security or any of the other programmes directly affected by economic assumptions, it is less necessary than previously to revise the assumptions now. We therefore suggest that you do not decide the assumptions until you have had a chance to discuss with officials the completed forecast - that discussion is due on 15 October - and decide what inflation figures you will be showing in the Industry Act forecast covering the early part of the survey period. But we are putting this submission forward now so that you should know what we expect to recommend and because you may want to have a private word with Lord Whitelaw to warn him of the possibility of a higher inflation forecast and its potential effect on the overall public expenditure figures: although there is no direct effect on the programmes which his group is considering this year, there could be some indirect effect if the debate in the Star Chamber turns on the level of programmes in real terms (though, of course, the Treasury would resist the suggestion that real terms should be a decisive factor, insisting that we conduct the Survey in cash).

4. Although the autumn forecast is not yet complete, it is clear that it is going to show significantly higher inflation from next year onwards, and also higher interest rates, than did the assumptions issued in March. Part of the reason for this revision is that demand and activity in the economy are significantly more buoyant this year and next than was envisaged at the time of the Budget. Another general reason for the higher inflation next year is an increased contribution from local authority rates and public sector prices. More generally the figures for inflation over the medium term set out in the MTFS deliberately include an element of ambition. While assumptions for this year and next will need to be updated in line with the new IAF, we do not normally, at this time of year, revise the published projections for the later years of the MTFS (ie after 1988). You have, in fact, already decided not to revise the growth rates for money GDP for the last two years of the survey period. Thus the revisions considered in this minute are confined to figures for 1987-88 and 1988-89.

Assumptions on Prices

5. Assumptions will be needed on:

(i) RPI increases over the years to September 1988 and September 1989, to determine the 1989 and 1990 Social Security upratings;

(ii) increases in the GDP deflator by financial year over the survey period.

(i) **The RPI**

6. The RPI assumptions for the 1989 and 1990 upratings (ie the increases in the RPI in the years to September 1988 and September 1989) will be published in the outline Public Expenditure Plans given in Part 2 of the Autumn Statement, and again in the PEWP. The Industry Act Forecast will include a forecast for the increase in the RPI over the year to 1988Q4, which will need to be consistent with the public expenditure assumption for September 1988.

7. We expect the increase in the RPI in the year to September 1987 to be 4.2 per cent, and you have already agreed the use of this estimate pending the publication of the actual figure on 18 October. For the fourth quarter of 1987 we expect the rate of inflation to average 4 per cent, in line with the Budget forecast. The rate of inflation will probably be above this in October, and below 4 per cent in November and December. RPI inflation will, however, almost certainly be rising again by next April, at the latest.

8. The tables below show the RPI assumptions for September 1988 and September 1989 that were issued in March and the corresponding figures that are emerging from the autumn forecasting exercise, described as "forecasters' current view". The forecast now shows a $5\frac{1}{2}$ per cent rise in the RPI in the year to September 1988, and a $5\frac{1}{4}$ per cent rise in the year to 1988 Q4.

Percent changes in RPI

	Q2 1987 to Q2 1988	September 1987 to September 1988	September 1988 to September 1989
Published 1987 PEWP assumptions		3½	
Published FSBR forecast	4		
Unpublished March assumptions circulated to Departments		3¾	3¼
Forecasters' current view		5½	4½

9. The main elements behind the current forecast increase in RPI inflation next year compared with this year are:

- assumed indexation of specific duties in the 1988 Budget after no indexation this year (worth around 0.3 per cent on inflation);

- substantial gas and electricity price increases (of 4 per cent and 8½ per cent respectively) after a 4½ per cent fall in gas prices and a marginal fall in electricity prices this year (the difference between the two years for gas and electricity is worth almost ½ per cent on RPI inflation);

- an 11 per cent average rise in local authority rate poundages in 1988 compared with about 7½ this year (the difference is worth about 0.15 per cent on inflation);

- with a forecast one point rise in mortgage interest rates between now and the start of 1988 the profile for interest rates over this year and next will add about 0.2 percentage points to inflation in 1988 Q4 compared with 1987 Q4;

- the rise in pay settlements that has occurred since the beginning of 1987 combined with some slowing down of productivity growth mean that unit labour costs will rise faster over the next year than over the last year.

10. The forecast for local authority rates derives from LG's and PSF's assessment of the effects of the rate support grant settlement, and a forecast that local authorities will exceed expenditure provisions by a substantial amount. The forecast for electricity prices and other nationalised industry prices in large part reflects agreements made or likely to be made with Departments during the course of the current round of public expenditure negotiations. The forecast for gas prices is derived from the formula that relates the price British Gas is allowed to charge to changes in crude oil prices and to RPI inflation.

11. Our forecast of inflation at 5¼ per cent in 1988 Q4 is above the latest average of outside forecasts (4.6 per cent). But outside forecasters will generally not be allowing for the sort of increases in rates and electricity prices (they know nothing about the latter) that we are expecting nor for the increase in mortgage interest rates built into our forecast. Inflation is expected to fall back in 1989 as economic growth eases back, and as some of the special factors affecting 1988 inflation cease to apply.

12. The likely contribution of public sector prices to inflation next year will start to emerge once the outline public expenditure plans are published in the Autumn Statement: the electricity industry is likely to comment on the implication for prices of its agreed EFL; and as the increase in AEG for 1988-89 is £400 million less than for 1987-88 the prospect of higher increases in rates will already be apparent although the scale of the increase will not be clear until authorities set their budgets in the early months of 1988. As the RPI table in the Industry Act Forecast always identifies separately the nationalised industry and housing components of the RPI, our assumptions in these areas are fairly transparent. Thus we can hardly avoid publishing an inflation forecast which takes reasonable account of the effect of the prospective increases in taxes and nationalised industry prices. With this contribution, it would be very difficult to explain a forecast that did not show a significant rise in inflation next year, given that there seems little prospect in the immediate future of costs decelerating to offset the factors discussed above.

13. One factor, however, contributing to higher inflation which you will probably want to remove from the published forecast, and hence not to allow for in the public expenditure RPI assumption, is the assumed rise in mortgage rates. We do not disclose the assumption on interest rates underlying published forecasts, and have tended not to include significant changes during the forecast period. We would not want to give the impression that we expect a rise in interest rates by publishing a forecast which appeared to be predicated on such a rise. Taking this rise in interest rates out brings the rate of inflation in both September 1988 and 1988Q4 down to 5 per cent.

14. We expect therefore to recommend an assumption of 5 per cent for the increase in the RPI in the year to September 1988, in line with the forecast adjusted to take out the effect of the rise in mortgage interest rates. We are also likely to recommend 5 per cent as the figure to be shown as the next Industry Act Forecast for inflation in 1988Q4, which will be published at the same time as the RPI assumption. The recommendation would change if there were a change in bank base rates between now and the Autumn Statemnt.

No: 4¾?

15. For the following year we are likely to recommend a continuation of the March RPI assumption of 3¼ per cent. This would be consistent with your decision not to re-open money GDP figures for the later years of the MTFS. Moreover, we will presumably want to argue that inflation is continuing to trend downwards, with fluctuation around that medium term trend: next year's relatively high figure is a temporary upward movement for specific reasons and will be quickly reversed.

16. The RPI excluding housing - the assumption for which is not published but which is used to uprate about a third of the social security programme - is expected to rise by 4½ per cent over the year to September 1988. This compares with an increase of 3¼ per cent in the March assumptions.

(ii) **GDP deflator**

17. The forecast for the GDP deflator in 1987-88 and 1988-89 will be published in the Industry Act Forecast while the assumptions for later years will be published in Part 2 of the Autumn Statement and in the

PEWP. The GDP deflator assumption has very little effect on the cash total of demand led public expenditure: its importance is in defining what the cash total represents in real terms.

18. The assumption does, however, have implications for public expenditure totals outside the area of demand led expenditure. In the Survey negotiations several departments have related their bids to the existing GDP deflator assumptions. Depending on the nature of the settlement, revisions to those assumptions may lead to accusations of double dealing by the Treasury and possibly to calls for the immediate re-opening of settlements that have been agreed, or for guarantees of compensation in the next Survey. In addition, there are some programmes, notably health, which are not yet settled and where, on learning of the change of assumptions, the department would revise its bid. In the case of health an extra 1 per cent could add £120 million a year to the bid. The likelihood of such difficulties will increase with the extent of the upward revision. GEP and expenditure divisions believe that a ½ per cent upward revision might be coped with but that a 1 per cent revision would be very likely to create difficulties with colleagues. As for the RSG settlements, provision was fixed on the assumption of a 4 per cent increase for the generality of authorities and services. LG's judgment is that an upward revision in the deflator of less than 1 per cent could probably be managed, but that a full 1 per cent increase would create significant pressures to re-open the totals of provision and grant.

19. The table below sets out the 1987 MTFS path of the GDP deflator (which is identical to the GDP deflator assumptions currently in use), with the forecasters' current view.

GDP deflator at market prices

(percent changes on previous financial year)

	1987-88	1988-89	1989-90	1990-91
1987 MTFS	4½	4	3½	3
Forecasters' current view	4½	5½	4¾	
June :	5	5½	5	

20. The CSO's published estimate for the GDP deflator in 1987Q2 (showing a 4.1 per cent rise over a year earlier) was unexpectedly low. As with real GDP estimates, early estimates of the GDP deflator tend to get revised up, and we would not be at all surprised to see a significantly higher figure emerge eventually. Nevertheless, we are constructing the forecast on the basis that there is nothing seriously wrong with the published estimate of the GDP deflator for the second quarter. The effect of this is that in spite of the rise in oil prices since March, we do not now forecast any overshoot of the Budget forecast for the GDP deflator in 1987-88, and there is no reason to change the March assumption for the current year.

21. Most of the factors (other than the rise in mortgage rates) that lead to a pick up in retail price inflation in 1988 also cause an acceleration in the GDP deflator in 1988-89. Given a recommendation that the RPI assumption for September 1988 be raised to 5 per cent, we also expect to recommend that the GDP deflator assumption be raised to 5 per cent for financial year 1988-89. Thereafter the MTFS path (ie the March assumption) would be retained.

22. The inflation (RPI and GDP deflator) assumptions that we are likely to recommend are summarised below, together with the average earnings assumption already agreed. The relatively small gap between earnings and prices in 1988-89 can be interpreted as reflecting the special factors, independent of wage costs, pushing up prices inflation in that year.

	1987-88	1988-89	1989-90	1990-91
RPI*	4.2	~~5~~ 4¾	3¼	
GDP deflator	4½	~~5~~	3½	3
Average earnings	7½	6½	5½	5

* September figures

Assumptions on interest rates

23. Interest rate assumptions are not published at any stage. The last interest rate assumptions, issued in March, were based closely on the projections underlying the MTFS.

24. The current forecast has higher UK interest rates for the present financial year, and also for later years. The rise in interest rates compared with the MTFS reflects the authorities' reaction (and the markets' expectation of their future reaction) to the buoyant state of demand; the higher rates for future years also reflect the differences between the current forecast and the MTFS on medium term inflation and money GDP prospects.

25. For the current financial year we expect to recommend adopting the forecast figures (which allow for a further one point rise in UK short rates over the next six months). For the last two years of the Survey period we are likely to recommend retaining the MTFS assumptions, in line with the recommendations on the inflation assumptions. For 1988-89, the intermediate year, we do not see a strong case for revising the March assumptions fully in line with the forecast. However, if the RPI assumption does not allow for the increase in interest rates assumed in the forecast, a consistent assumption for the UK interest rate figures would be to hold them in 1988-89 constant at their 1987-88 levels, ie at 10 per cent.

26. We have for some time been forecasting a rise in US interest rates, which has begun to occur. The assumptions adopted for US interest rates are normally based closely on the latest forecast, and we are likely to recommend this time following the normal practice (this involves relatively little change to the March assumptions on dollar interest rates).

27. The table below sets out the likely recommendations for interest rates.

Interest rates (financial year averages)

	Latest	1987-88	1988-89	1989-90	1990-91
UK 3-month LIBOR					
March assumptions		9¾	9½	9½	9
Forecasters' current view	10.2	10	11	11	
Proposals		**10**	**10**	**9½**	**9**
UK 20-year gilt rate					
March assumptions		9	9	9	9
Forecasters' current view	10	10¼	11	11	
Proposals		**10**	**10**	**9**	**9**
6-month dollar LIBOR					
March assumptions		7	8½	9	9½
Forecasters' current view	8.3	7¾	8¾	9	
Proposals		**7½**	**8½**	**9**	**9**

Effect of revised assumptions

28. The upward revisions to interest rates and inflation proposed in this submission would add to the totals for demand led expenditure: the increases would be approximately as given below. (No allowance is made for any re-opening of agreements outside the area of demand led expenditure as a result of the higher GDP deflator assumptions for 1988-89.)

	1988-89	1989-90	1990-91
RPI		505	530
Interest rates	60	- 10	15
Total demand led expenditure	60	495	545

Rb/o on base 4¾% RPI
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ANNEX TABLE 1

LIST OF ECONOMIC ASSUMPTIONS

		1987-88	1988-89	1989-90	1990-91
1.	**Unemployment, GB narrow (millions)**				
	(1986-87 and 1987-88 published in November GAD report, and part 3 of Autumn Statement. Later years in 1987 PEWP and Part 2 of Autumn Statement).				
	January 1987 PEWP (published)	3.05	3.05	3.05	
	Already agreed for 1988 PEWP	**2.7**	**2.6**	**2.6**	**2.6**
2.	**RPI (% change over specified periods).**	**Sept 87 / Sept 86**	**Sept 88 / Sept 87**	**Sept 89 / Sept 88**	
	(Outturn September 87 figure will be published in October. Figures for later years will be published in the PEWP and Part 2 of Autumn Statement.)				
	March assumptions	4¼	3¾	3¼	
	Forecasters' current view	4.2	5½	4½	
	Already agreed	**4.2**			
	Proposed		**5**	**3¼**	
3.	**Average earnings per head (% change on year earlier).**	**1987-88**	**1988-89**	**1989-90**	**1990-91**
	(1987-88 and 1988-89 published in November GAD report and part 3 of Autumn Statement; later years not published.)				
	April 1987 GAD report (published)	6½			
	March 1987 assumptions (unpublished)		6	5½	5
	Already agreed	**7½**	**6½**	**5½**	**5**
4.	**GDP deflator (% change on year earlier**	**1987-88**	**1988-89**	**1989-90**	**1990-91**
	(Figures published in part 2 of Autumn Statement and in PEWP.)				
	March 1987 Assumptions (published in MTFS/FSBR)	4½	4	3½	3
	Forecasters' current view	4½	5½	4¾	
	Proposed	**4½**	**5**	**3½**	**3**

INTEREST RATE ASSUMPTIONS (UNPUBLISHED)

5. **3-Month Sterling LIBOR (financial year averages)**

	1987-88	1988-89	1989-90	1990-91
March assumptions	9¾	9½	9½	9
Forecasters' current view	10	11	11	
Proposed	**10**	**10**	**9½**	**9**

6. **Sterling 20 Year Gilt Rate (financial year averages)**

	1987-88	1988-89	1989-90	1990-91
March assumptions	9	9	9	9
Forecasters' current view	10¼	11	11	
Proposed	**10**	**10**	**9**	**9**

7. **6-Month Dollar LIBOR Rate (financial year average).**

	1987-88	1988-89	1989-90	1990-91
March assumptions	7	8½	9	9½
Forecasters' current view	7¾	8¾	9	
Proposed	**7½**	**8½**	**9**	**9**

ANNEX Table 2

EFFECT OF CHANGES IN ASSUMPTIONS ON THE PUBLIC EXPENDITURE PLANNING TOTALS

	£ million			
	1987-88	1988-89	1989-90	1990-91
100,000 rise in unemployment				
DHSS	215	220	225	225
One point rise in sterling interest rates				
ECGD (short rates)*	14	55	52	48
Housing subsidies (pool rate**)	90	90	100	120
DTI credit to shipbuilders (short rates)	2	7	7	7
One point rise in dollar interest rates*				
ECGD	0	12	14	17
One per cent higher September 1988 RPI relevant to April 1989 uprating***				
DHSS			405	425

* Calculations assume initial change occurs in 1987-88 and is sustained in following financial years.

** Housing subsidy pool rate responds with a lag to changes in short and long rates.

*** Ready reckoner applies to one point change in both the all items RPI and RPI excluding housing.

ANNEX Table 3 PUBLICATION OF ECONOMIC ASSUMPTIONS

	AUTUMN STATEMENT	GOVERNMENT ACTUARY'S ANNUAL REPORT	PUBLIC EXPENDITURE WHITE PAPER
DATE DUE	**November**	**November**	**January**
UNEMPLOYMENT	Figures shown in PEWP are also given in Part 2 of AS.	Financial year averages for 1987-88 and 1988-89 shown as basis for estimates of expenditure on social security.	Financial year averages up to 1990-91 shown as basis for estimates of expenditure on social security.
RPI	Figures shown in PEWP are also given in Part 2 of AS. **The Industry Act forecast will also show annual percentage changes to 1987Q4 and 1988Q4.**	Percentage increase in year to September 1987 shown as basis for estimates of expenditure on social security.	Annual percentage increases up to September 1989 shown as basis for estimates of expenditure on social Secuity.
AVERAGE EARNINGS	As for GAD Annual Report. Internal forecast used to derive published estimates of government revenue.	Average growth rates to 1987-88 and 1988-89 shown, as basis for estimates of income from NI contributions.	Not shown. But used for calculating family income supplement and housing benefit.
INTEREST RATES	Not shown. But figures used as basis for estimating expenditure on various programmes (eg interest support costs, housing).	Not relevant.	Not shown. But figures up to 1990-91 used as basis for estimating expenditure on various programmes and debt interest payments.
GDP DEFLATOR	Shown in Part 2 of AS.	Not relevant.	Financial year percentage increases up to 1990-91 shown. They determine cost terms for public expenditure.

CONFIDENTIAL

FROM: S J DAVIES
DATE: 18 SEPTEMBER 1987

CHANCELLOR OF THE EXCHEQUER

cc : Chief Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Kemp
Mr Monck
Mr Burgner
Mr H P Evans
Mr Odling-Smee
Miss Peirson
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mrs R Butler
Mr Gieve
Mr Gilhooly
Mr Gray
Mr McIntyre
Mr Mowl
Mr Allum
Mr Cunningham
Mr Call
Mr Cropper
Mr Tyrie

Ch
OK?
AA

Content

ECONOMIC ASSUMPTIONS FOR PUBLIC EXPENDITURE

Economic assumptions need to be agreed at around this time of year in order to provide an up to date basis for Ministerial discussion as the Public Expenditure Survey figures for demand led expenditure are finalised. The agreed assumptions will be published over the next few months: in the Autumn Statement, the Public Expenditure White Paper, and the November Report of the Government Actuary. (Table 3 of the Annex sets out when and where the various assumptions are published).

2. As at this time last year, we are asking you ahead of any firm results from the autumn forecasting exercise to approve certain assumptions where the choice of assumption would not be much, if at all, affected by the outcome of the forecast; approval this early is needed to permit the Social Security expenditure figures to be reworked in time for the initial paper for the Star Chamber in early October. The remaining assumptions will be the subject of a further submission at the beginning of October by when we should have a reasonable idea of how the autumn economic forecasting exercise is turning out.

EcAssp
Sept87

3. This submission covers proposals on;

(i) the unemployment path over the PEWP period;

(ii) the 1988 uprating (ie the RPI figure for September 1987);

(iii) the average earnings assumption for the PEWP period.

The unemployment assumption published every year in the PEWP (and Autumn Statement) is normally a stylised path rather than a forecast. Thus while the choice of unemployment assumption for the next PEWP is certainly affected by what we expect to happen to unemployment over the next two or three months, the choice is not really affected by the forecast of unemployment trends beyond the current financial year. The proposals in this submission take account of the latest data on unemployment, average earnings, and retail prices (the latest figures for all three have been published over the last week).

The unemployment assumption

4. An unemployment assumption for 1987-88 and the following financial year will be published in November in the Government Actuary's report. The assumption for the whole of the Survey period will be published in Part 2 of the Autumn Statement and in the PEWP. The last published assumption (which appeared in the 1986 Autumn Statement and 1987 PEWP) is shown in the table below together with the unpublished assumptions subsequently issued to Departments (in March and July); also shown is the forecasters' current view (which is subject to revision in the latter part of the autumn forecasting round).

GB adult unemployment (millions)

	1987-88	1988-89	1989-90	1990-91
1987 PEWP	3.05	3.05	3.05	
March assumption	2.8	2.8	2.8	2.8
July assumption	2.7	2.7	2.7	2.7
Forecasters' current view	2.7	2.5		

5. In August, GB adult unemployment stood at 2,708 thousand, having fallen by an average of 39 thousand a month over the most recent three months, and at the same average rate over the most recent six months. If unemployment continues to fall at around the recent rate for two more months - and the implication of recent CBI data showing buoyant output expectations and demand for labour is that a strong downward trend in unemployment will continue for some while yet - the October unemployment figures published in mid November will show unemployment a little below 2.65 million. By January, when the PEWP is published, unemployment could well be below 2.6 million.

6. For the current financial year there seems no reason to change the July assumption of 2.7 million, which is the outturn the forecasters still expect for the financial year average. For the later years, a prime consideration is to choose a figure which looks sufficiently conventional for us to avoid having to defend it as if it were a realistic forecast. The choice probably lies between:

- 2.7 million, the same as recommended for the current financial year;

- 2.65 million, close to the level of unemployment expected in the set of labour market statistics announced in November;

- 2.6 million, close to the likely level of unemployment at around the time the PEWP is published.

7. We do not recommend 2.7 million as the assumption for the later years. By November the actual level of unemployment is likely to be below this level, and publishing then an assumption of 2.7 million might create the impression that the government expects unemployment to start rising again over the coming year. Moreover the adoption of 2.7 million now would imply a <u>higher</u> underlying level of unemployment than is currently in PESC. The 2.7 million figure issued in July took no credit for the withdrawal of income support from sixteen and seventeen year olds in September 1988 which is expected to reduce the adult count by some 80 thousand; PESC figures for social security expenditure have already been reduced to allow for unemployment falling <u>below</u> 2.7 million when this measure is introduced.

8. The choice therefore lies between 2.6 and 2.65: of the two 2.6 has the advantage of being a more rounded number. While it is likely to be below the actual level of unemployment announced in the November set of statistics, it should have a fairly conventional look about it: the current trend extrapolated a month or two forward and no change assumed thereafter. Moreover, having started the current financial year at almost 2.9 million, the unemployment level needs, as a simple matter of arithmetic, to fall to around 2.6 million in the latter part of 1987-88 in order to achieve the proposed 2.7 average for 1987-88. Thus 2.6 million for 1988-89 will look like an extrapolation of what we are obviously assuming for the end of 1987-88. We recommend 2.6 million for 1988-89 and the following two years. We do not recommend a lower number. 2.5 million could look in November a rather low choice if by any chance the next two monthly unemployment figures were relatively disappointing, and would be hard to explain or defend except as a forecast. To summarise, the proposed unemployment assumption is:

1987-88	1988-89	1989-90	1990-91
2.7	2.6	2.6	2.6

9. The proposed path follows the same pattern as in the last two Autumn Statements, ie a slightly lower level in the three forward years than in the current year. In the 1985 Autumn Statement, the assumption was 3.05 million in 1985-86 and 3 million in each of the subsequent years; and in the 1986 Autumn Statement the assumption was 3.1 million in 1986-87 and 3.05 million in each of the subsequent years.

The 1988 uprating

10. The 1988 social security uprating will be determined by the increase in the RPI over the year to September 1987. DHSS need our best guess at this now. (They will, of course, have to rework their expenditure estimates again when the September RPI is published unless our proposed figure is exactly right.)

11. We now expect that the increase in the all items RPI in the year to September will be 4.2 per cent (compared with 4.4 per cent in the year to August). (The main reason for the decline in the twelve-month

rate between August and September is that last year there was a very large petrol price increase between the two months which has not been repeated this year.) This is virtually the same as we expected at Budget time: the assumption that DHSS are currently using, that was originally issued in March, is for a 4¼ per cent increase in the RPI over the year to September 1987. The RPI excluding housing - which is used to update about a third of the social security programme - is expected to rise by 3.1 per cent in the year to September 87 (just below the March assumption of 3¼ per cent).

12. The forecast is not sufficiently far advanced for us to propose revised RPI assumptions for later years: these will be covered in the next submission.

Average earnings

13. The average earnings assumptions issued in March were:

1987-88	1988-89	1989-90	1990-91
6½	6	5½	5

The 6½ figure for 1987-88 had previously been published in the PEWP: no assumption for later years has yet been published. We never actually expected the outturn for 1987-88 to be as low as 6½ per cent; the recent high level of overtime means that the outturn could possibly be as high as 8 per cent. For the first four months of the financial year, Department of Employment's average earnings statistics have shown underlying growth rates on a year earlier of 7¾ per cent, and it is possible that this figure will move up to 8 per cent in a month or two's time.

14. The choice of earnings assumption has relatively little effect on estimated expenditure, and is determined on presentational grounds. The lowest figure that could be defended as at all likely for earnings growth in the current financial year is 7½ per cent, and we recommend that the assumption for 1987-88 be now revised to 7½ per cent. This figure will be published in the Autumn Statement and in the Government Actuary's November report. A figure for 1988-89 will also be published. It is unlikely that the internal autumn forecast will show

much if any deceleration of earnings growth in the next financial year: although overtime payments may contribute less next year, there have recently been signs of some upward trend in private sector pay settlements. However, you will obviously want the published assumptions to show a fall in earnings growth next year. We recommend a repeat of the profile adopted this time last year; ie to follow 7½ per cent in the current year with 6½ per cent next year. As last year, we will ask the Government Actuary to make it clear that pay settlements will be lower than these increases in average earnings.

15. For the later years (for which figures are not published) we also recommend a repeat of last year's profile: this would mean 5½ and 5 in the last two years of the survey period, no change from the March assumption. To summarise, the proposed average earnings profile is:

1987-88	1988-89	1989-90	1990-91
7½	6½	5½	5

Effect on public expenditure

16. Table 2 in the Annex gives ready reckoners for the effects of changes in the unemployment and RPI assumptions on demand led expenditure. The effect of the revisions proposed in this submission on the expenditure figures currently in PESC will be approximately as follows:

	1988-89	1989-90	1990-91
Unemployment	- 195	- 115	- 115
RPI	- 35	- 35	- 35
Total	- 230	- 150	- 150

(Note that the expenditure revision given for the change to the unemployment assumption is less than the full expenditure effect of a 100,000 reduction in unemployment, because PESC already takes credit for a reduction in unemployment below the July assumption on account of the withdrawal of income support for sixteen and seventeen year olds from September 1988).

Approval

17. We would like to send the revised assumptions to DHSS on 22 September. We would be grateful for your approval of the proposals by that date.

S J DAVIES

ANNEX Table 1

ASSUMPTIONS ON UNEMPLOYMENT, THE RPI, AND AVERAGE EARNINGS

Unemployment GB narrow (millions)	**1987-88**	**1988-89**	**1989-90**	**1990-91**
Published PEWP/GA assumptions	3.05	3.05	3.05	
Unpublished March assumptions	2.8	2.8	2.8	2.8
Updated July assumptions	2.7	2.7	2.7	2.7
Forecasters' latest projection	2.7	2.5		
Proposed assumptions	**2.7**	**2.6**	**2.6**	**2.6**

RPI (per cent changes)	**Year to September 1987**	**Year to September 1988**	**Year to September 1989**
Published PEWP assumptions	3¾	3½	
Unpublished March assumptions	4¼	3¾	3¼
Forecasters' latest projection	4.2		
Proposed assumptions	**4.2**	(3¾	3¼)

Average earnings (per cent changes)	**1987-88**	**1988-89**	**1989-90**	**1990-91**
PEWP/GA assumptions*	6½	5½	5	
Unpublished March assumptions	6½	6	5½	5
Forecasters' latest projection	8	8		
Proposed assumptions**	7½	6½	5½	5

* Figures after 1987-88 were not published

** Only figures for 1987-88 and 1988-89 will be published.

ANNEX Table 2

EFFECT OF CHANGES IN ASSUMPTIONS ON THE PUBLIC EXPENDITURE PLANNING TOTALS

	£ million			
	1987-88	1988-89	1989-90	1990-91
100,000 rise in unemployment				
DHSS	215	220	225	225
One per cent higher September RPI relevant to April uprating				
DHSS		405	425	425

ANNEX Table 3 PUBLICATION OF ECONOMIC ASSUMPTIONS

	AUTUMN STATEMENT	GOVERNMENT ACTUARY'S ANNUAL REPORT	PUBLIC EXPENDITURE WHITE PAPER
DATE DUE	**November**	**November**	**January**
UNEMPLOYMENT	Figures shown in PEWP are also given in Part 2 of AS.	Financial year averages for 1987-88 and 1988-89 shown as basis for estimates of expenditure on social security.	Financial year averages up to 1990-91 shown as basis for estimates of expenditure on social security.
RPI	Figures shown in PEWP are also given in Part 2 of AS. **The Industry Act forecast will also show annual percentage changes to 1987Q4 and 1988Q4.**	Percentage increase in year to September 1987 shown as basis for estimates of expenditure on social security.	Annual percentage increases up to September 1989 shown as basis for estimates of expenditure on social Secuity.
AVERAGE EARNINGS	As for GAD Annual Report. Internal forecast used to derive published estimates of government revenue.	Average growth rates to 1987-88 and 1988-89 shown, as basis for estimates of income from NI contributions.	Not shown. But used for calculating family income supplement and housing benefit.
INTEREST RATES	Not shown. But figures used as basis for estimating expenditure on various programmes (eg interest support costs, housing).	Not relevant.	Not shown. But figures up to 1990-91 used as basis for estimating expenditure on various programmes and debt interest payments.
GDP DEFLATOR	Shown in Part 2 of AS.	Not relevant.	Financial year percentage increases up to 1990-91 shown. They determine cost terms for public expenditure.

3.7.6

CONFIDENTIAL

FROM: MISS M E PEIRSON
DATE: 3 JULY 1987

CHANCELLOR

cc Chief Secretary
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mrs R Butler
Mr S J Davies
Mr Gieve
Mr McIntyre
Mr Mowl
Mr Cropper
Mr Tyrie

C/ Content to agree to 2.7 for 87-8?

Ch
Surely we should go for 2.7 for all 3 years (or none of them). Otherwise leaks that we're expecting a rise in unemployment
AA

CR 3/7

OK: use 2.7 for 1987-88 — but we must then stick to the convention & leave 2.7 throughout the rest of the Survey. Important, too. NL

ECONOMIC ASSUMPTIONS FOR PUBLIC EXPENDITURE

I understand that, concerning Mr Davies' submission of 1 July, you are disinclined to change the economic assumptions issued to Government Departments at present. I should nonetheless like to urge one small change, to the unemployment assumption, for DHSS only. I suggest that we would not ask them to change the assumption of 2.8 million for the Survey years (1988-89 onwards) but to reduce it to 2.7 million for 1987-88 alone. This reflects discussion with Mr F E R Butler.

2. The reason for wanting to change the assumption in 1987-88 is as follows. As you know, DHSS now have (thanks in large part to the Treasury) a pretty reliable system (formerly known as "FOSSE", now known as "CYMS") for short-term forecasting. Last year it proved very reliable in forecasting for 1986-87, and accordingly we place considerable faith in its present forecasts for 1987-88. DHSS are not keen on it, refusing entirely to use it for future years, and need encouragement from us to stick with it even for the current year. The CYMS system depends on good assumptions on unemployment etc being fed into it, and so it is in the Treasury's interests to give the best assumptions we can. Last year DHSS complained when we would not change the unemployment assumption mid-year to what seemed at that stage the most likely outcome, and they claimed that CYMS could not cope.

3. We should therefore like to get the current year as right as possible, and that seems to mean choosing 2.7 instead of 2.8, given where unemployment has already got to.

4. However, for 1988-89 onwards we would be content to leave the DHSS with the present assumption of 2.8 million. A lower assumption would mean a lower DHSS forecast, and we believe their forecast is already unrealistically low. Moreover, if there were, in the autumn, an upwards revision of the inflation assumption (for September 1988, affecting 1989-90 onwards) that would more or less offset the effect of any reduction then in the unemployment assumption.

Conclusion

5. Accordingly, if you agree, we should like to ask the DHSS not to change any of their assumptions for the time being, except to use 2.7 million for unemployment in 1987-88 only.

MEP

MISS M E PEIRSON

FROM: S J DAVIES
DATE: 1 JULY 1987

CHANCELLOR OF THE EXCHEQUER

cc : Chief Secretary
Sir Peter Middleton
Sir Terence Burns
Mr F E R Butler
Mr Anson
Mr Cassell
Mr Kemp
Mr Monck
Mr Burgner
Mr H P Evans
Mr Odling-Smee
Miss Peirson
Mr Peretz
Mr Scholar
Mr Sedgwick
Mr Turnbull
Mrs R Butler
Mr Gieve
Mr Gilhooly
Mr Gray
Mr McIntyre
Mr Mowl
Mr Riley
Mr Allum
Mr Cunningham
Mr Cropper
Mr Tyrie

C/content with proposals?

CR 1/7

Ch
Mostly OK. But problems on inflation
(1) I doubt you'll want to go over 4% for RPI to Sept 88 — perhaps case for sticking to 3¾%? (paras 8-12)
(2) Do you yet want to go as high as 5% for GDP deflator in 1987-88? (paras 13-14)

AA

ECONOMIC ASSUMPTIONS FOR PUBLIC EXPENDITURE

1. Government departments use economic assumptions provided by the Treasury to forecast public expenditure in a number of areas where expenditure is "demand-led", ie determined by economic conditions - the number of people unemployed, the rate of inflation - rather than held to some total agreed in advance. The most important of these assumptions are those for prices, earnings, unemployment and interest rates.

2. Economic assumptions are provided by the Treasury up to four times a year. Assumptions reflecting the Industry Act Forecast and MTFS projections published in the FSBR are provided in March/April at the start of annual Public Expenditure Survey, and the bids current at the public expenditure Cabinet in July are based on these assumptions. Assumptions reflecting the Treasury's autumn forecasting round are

provided to Departments in September/October for use in the Star Chamber negotiations and for publication in the Autumn Statement and Public Expenditure White Paper. These are the two major rounds of assumptions.

3. When necessary, we also update some of the assumptions in July (following the Treasury's summer forecasting exercise), for use in the bilateral discussions between the Chief Secretary and Departments in September. It is particularly desirable that DHSS have the best possible assumptions for their July forecasting round, so that the bilaterals are well-based. Updated assumptions are also sometimes provided in January for use in the work leading up to the publication of Estimates on Budget day. Current arrangements for the provision of economic assumptions to Departments for their forecasts of demand-led public expenditure follow the recommendations made in 1984 in the Anson report on "Monitoring and Forecasting of Demand-led Expenditure".

4. This submission considers the extent to which the March assumptions need to be updated for the bilaterals, in the light of the results of the June forecast which you have just received (Peter Sedgwick's submission of 29 June).

5. We are not proposing a general revision of the assumptions for the whole of the Survey period in the light of the latest forecast. At this time of year we try to avoid changes to the assumptions for the years based on the MTFS projections. Thus while the tables at the end set out figures from the new forecast up to 1989-90, the revisions to assumptions proposed in this submission just reflect changes to the prospects for the next year or so. You may want to give more consideration to changes for later years when the assumptions are revised again in September or October. The figures decided then for unemployment, earnings and inflation will be published in the Autumn Statement and PEWP. No assumptions are published at this time of year.

Unemployment

6. The assumptions issued in March had GB adult unemployment averaging 2.8 million in the current financial year. Following the usual practice of a stylised path for unemployment over the Survey period, the March assumptions had unemployment flat at 2.8 million up to 1990-91. The fall in unemployment in recent months has been a little larger than expected in March; and in May, when UK adult unemployment fell below three million, GB unemployment was down to 2.83 million. Taking account of the recent months' figures, and also of the likelihood that economic growth in 1987 will be higher than forecast at the time of the Budget, we now expect unemployment to average 2.7 million in 1987-88 as a whole. The forecast shows a further fall in unemployment in 1988-89, to around 2.5 million.

7. For 1987-88 we propose to revise the unemployment assumptions down in line with latest forecast, ie to 2.7 million. For the later years the choice, on the basis of recent precedent, is between:

(i) a continuation of 2.7 million, or

(ii) assuming unemployment constant at a lower number, eg 2.6 million.

In the last two PEWPs unemployment has been projected over the Survey period at a figure below the expected average for the current year: eg the 1987 PEWP projected unemployment at 3.05 million over the years starting 1987-88, while unemployment had been expected (at the time the assumptions were finalised) to average 3.1 million in 1986-87. One motivation for this type of profile has been that it has effectively allowed the projections of expenditure on unemployment benefits to take some credit for the impact of employment measures. You may well decide in September to adopt a similar sort of profile for the next PEWP's unemployment assumptions (eg 2.6 million in 1988-89 and later years after 2.7 million this year). The choice of assumption for the PEWP will obviously depend on whether unemployment is still falling fast in a few months' time. For the present we recommend simply assuming 2.7 million over the Survey period.

Unemployment Assumptions (GB adult, millions)	1987-88	1988-89	1989-90	1990-91
March assumptions	2.8	2.8	2.8	2.8
Proposed assumptions	2.7	2.7	2.7	2.7

Retail prices index

8. RPI inflation is expected to be slightly lower at the end of this year than forecast at Budget time; but over the medium term the latest forecast has inflation significantly above MTFS projections. The June forecast is consistent with a rise in the RPI of $4\frac{1}{4}$ per cent over the year to September 1987 (the period relevant to the April 1988 social security uprating): the same as the March assumption. The forecast is for a rise in the RPI of 5 per cent over the year to September 1988 (relevant to the 1989 uprating), compared with the March assumption of $3\frac{3}{4}$ per cent. (The new forecast includes a one point rise in mortgage rates over this period). Inflation in the fourth quarter of 1988 (for which a figure will be published in the Autumn Statement) may also be around 5 per cent.

9. For the 1988 uprating we propose simply to retain the March assumption, as it is in line with the new forecast. The assumption on the 1989 uprating is more difficult. The figure to be published in the next PEWP will have to be determined in the autumn in relation to the inflation figure to be published in the next Industry Act forecast. ?? We do not want to choose a figure now which has to be raised again in September: an upward revision to the uprating assumption at such a late stage of the Survey would cause problems (downward revisions will be easier to cope with). On the other hand you may not want now to put into circulation in Whitehall an inflation projection that is substantially above the previous assumption.

10. Moreover, to adopt a figure for inflation in September 1988 close to that in the forecast and then to revert to the previous assumption for September 1989 would produce a rather bumpy path for inflation which may be difficult to explain to Departments. The forecast shows a rather pronounced cycle in inflation, which rises to 5 per cent in the second half of 1988 and then fall back to around 4 per cent by the end of 1989; even if the general picture is right the

precise timing of the rise and fall in inflation - and in particular the precise months in which the predicted increases in mortgage rates will occur - is very uncertain. This point may argue for using a smoother inflation profile than suggested by the forecast. Our proposal assumes that you will not want to make more than a small upward revision to the March assumption for the 1989 uprating, and has 4 per cent now, compared with 3¾ per cent in March.

11. It does of course mean that, using these assumptions, DHSS will understate social security expenditure relative to what would be expected on the basis of the latest Treasury forecast - by some £300 million. Thus the objective of establishing now a cash total for 1989-90 that can realistically be expected to be sustained next year would clearly be undermined to some extent if this proposal were adopted. You will therefore want to consider alternatives of 4½ per cent or 5 per cent (in line with the forecast) for this assumption. We do not propose to change the March assumption (based on the MTFS) for the increase in the RPI in the year to September 1989, which determines the 1990 uprating.

q £375m

Retail price index assumptions

Increases in September over previous September

	1987	**1988**	**1989**
March assumption	4¼	3¾	3¼
Proposed assumptions	4¼	4	3¼
Alternative assumptions	4¼	4½(or 5)	3¼

12. The RPI excluding housing - the assumption for which is not published but which is used for uprating about a third of the social security programme - is expected to rise by about 3½ per cent in the year to September 1987 and by about 4¼ per cent in the year to September 1988 (March assumptions were 3¼ per cent for both years). We propose to provide DHSS with the new forecast figure (3½ per cent) for the year to September 1987 and to tell them to assume 4 per cent, the same increase as for the all items RPI, in the following year.

+¼ in both yrs!

GDP deflator

13. The assumptions issued in March for the GDP deflator were the same as the MTFS projections published in the 1987 FSBR. We do not suggest revising the MTFS projections beyond this year, but we are proposing an upward revision to the GDP deflator for the current year. The latest forecast has a rise in the GDP deflator of 5 per cent in 1987-88, ½ percentage point more than was forecast at Budget time.

14. The table below gives the March (MTFS) assumptions for the GDP deflator, with the revised assumptions now proposed.

GDP deflator, per cent changes on previous year

	1987-88	**1988-89**	**1989-90**	**1990-91**
March assumption (MTFS)	4½	4	3½	3
Proposed assumptions	5	4	3½	3

Average earnings

15. The average earnings assumptions issued in March were:

Average earnings, per cent changes on previous year

1987-88	**1988-89**	**1989-90**	**1990-91**
6½	6	5½	5

The figure for 1987-88 was unchanged from the earnings assumption published in the PEWP, and was below what the forecasters actually expected at Budget time. The recent strength of the economy, and the subsequent rise in overtime payments, makes it even less likely that earnings growth for the current year will come out as low as 6½ per cent. The latest figure for average earnings (for April) shows underlying growth of 7¾ per cent over the last year. Unless there is a clear deceleration in earnings over the next few months it looks as though in the autumn we may end up having to publish a figure as high as 7½ per cent as the assumption for the current year. To achieve an average increase as low as 6½ for 1987-88 on average would require earnings growth to fall to 5½ per cent by the end of the financial year, assuming smooth deceleration through the year.

16. The figures for publication in the Government Actuary's report and the PEWP (for 1987-88 and 1988-89) will be decided when the assumptions are revised again in September/October. For the present we propose to revise the 1987-88 figure up to 7 per cent. (Although the earnings assumption has only a small effect on projections of demand-led expenditure, we would prefer to issue a figure that we can defend to GAD, who use the figure: as discussed in the previous paragraph 6½ would now be difficult to defend.) For later years we propose no changes at present. Thus the earnings assumptions now proposed are:

Proposed average earnings assumptions,
per cent changes on previous year

1987-88	1988-89	1989-90	1990-91
7	6	5½	5

PK

Interest rates

17. So far this year UK interest rates have fallen a little more than implied by the assumptions issued in March, while US rates are higher than assumed. After allowing for a forecast rise in UK rates during the latter part of this year, short rates may be a little below the March assumptions in 1987-88 as a whole; while the average for long rates this year is more or less in line with the March assumptions. The table below sets out the interest rates in the June forecast, along with the March assumptions and figures for the current level of interest rates.

	Latest (close 29 June)	1987-88	1988-89	1989-90	1990-91
3-month sterling inter-bank					
March assumption		9¾	9½	9½	9
June forecast	(9.2)	9.5	10.4	10.5	
20-year gilt rate					
March assumption		9	9	9	9
June forecast	(9.1)	9.2	10.2	10.25	
6-month dollar LIBOR					
March assumption		7	8½	9	9½
June forecast	(7.5)	8	9	10	

18. The only changes proposed are a small downward revision of the assumption on UK short rates for this financial year (from 9¾ to 9½) and an upward revision to the US interest rate assumption for the current financial year (from 7 to 8). No changes are proposed for the later years.

19. The revised interest rates assumptions, which are not published at any stage, are summarised below:

	Proposed interest rate assumptions 1987-88	1988-89	1989-90	1990-91
3 month sterling interbank	9½	9½	9½	9
20-year gilt rate	9	9	9	9
6-month dollar LIBOR	8	8½	9	9½

Effects on expenditure

20. Table 3 in the annex sets out a ready reckoner indicating the approximate effect on forecast expenditure of changes to the economic assumptions. The table below summarises the effect of the revisions proposed in this submission:

Changes to expenditure, compared with July bids (£million)

	1987-88	**1988-89**	**1989-90**	**1990-91**
Unemployment	- 220	- 220	- 220	- 220
RPI	-	+ 30	+ 210	+ 210
Interest rates	- 10	0	0	0
Total	- 230	- 190	- 10	- 10

Decisions

21. We are hoping to send new assumptions to DHSS by Friday 3 July. I would therefore be grateful if you could approve the assumptions by that date.

S J DAVIES

ANNEX **Table 1**

ASSUMPTIONS ON UNEMPLOYMENT, EARNINGS AND INFLATION

Unemployment GB narrow (millions)	**1987-88**	**1988-89**	**1989-90**	**1990-91**
Published PEWP/GA assumptions	3.05	3.05	3.05	
Unpublished March assumptions	2.8	2.8	2.8	2.8
June Forecast	2.7	2.5	2.5	
Proposed Assumptions	2.7	2.7	2.7	2.7

Average earnings per head (per cent changes)	**1987-88**	**1988-89**	**1989-90**	**1990-91**
Published PEWP assumptions	6½			
Unpublished PEWP assumptions		5½	5	
Unpublished March assumptions	6½	6	5½	5
June Forecast	7½	7½	7½	
Proposed Assumptions	7	6	5½	5

RPI (per cent changes)	**Year to September 1987**	**Year to September 1988**	**Year to September 1989**
Published PEWP assumptions	3¾	3½	
Unpublished March assumptions	4¼	3¾	3¼
June Forecast	4¼	5	4¼
Proposed Assumptions	4¼	4	3¼

GDP deflator (per cent changes)	**1987-88**	**1988-89**	**1989-90**	**1990-91**
Published PEWP assumptions	3¾	3½	3	
March assumptions (Published in FSBR/MTFS)	4½	4	3½	3
June Forecast	5	5½	5	
Proposed Assumptions	5	4	3½	3

ANNEX Table 2

ASSUMPTIONS ON INTEREST RATES

3-month interbank rate	1987-88	1988-89	1989-90	1990-91
Unpublished PEWP assumptions	10¼	8½	8	
Unpublished March assumptions	9¾	9½	9½	9
June forecast	9.5	10.4	10.5	
Proposed Assumptions	9½	9½	9½	9

20 year gilt rate	1987-88	1988-89	1989-90	1990-91
Unpublished PEWP assumptions	10¼	9	8½	
Unpublished March assumptions	9	9	9	9
June Forecast	9.2	10.2	10.25	
Proposed Assumptions	9	9	9	9

6-month Dollar LIBOR	1987-88	1988-89	1989-90	1990-91
Unpublished PEWP assumptions	8	8¼	8¾	
Unpublished March assumptions	7	8½	9	9½
June WEP Forecast	8	9	10	
Proposed Assumptions	8	8½	9	9½

ANNEX Table 3

EFFECT OF CHANGES IN ASSUMPTIONS ON THE PUBLIC EXPENDITURE PLANNING TOTAL

	£ million			
	1987-88	1988-89	1989-90	1990-91
100,000 rise in unemployment				
DHSS	215	220	225	225
One point rise in sterling interest rates				
ECGD (short rates)*	22	54	52	48
Housing subsidies (pool rates**)	90	90	100	120
DTI credit to shipbuilders (short rates)	7	7	7	7
One point rise in dollar interest rates*				
ECGD	3	12	13	18
One per cent higher September RPI relevant to April uprating***				
DHSS		405	425	425

* Calculation assumes initial change occurs in 1987-88 and is sustained for the following three financial years.

** Housing subsidy pool rate responds with a lag to changes in short and long rates

*** Ready reckoner applies to one point change in both the all items RPI and the RPI excluding housing.

SECRET

10 DOWNING STREET

LONDON SW1A 2AA

CH/EXCHEQUER
REC. 06 OCT 1987
ACTION CST
COPIES TO

From the Private Secretary

5 October 1987

1. Catty
2. PUP

Dear Jill,

PROSPECTS FOR THE 1987 PUBLIC EXPENDITURE SURVEY

The Prime Minister held a meeting this morning to discuss the prospects for the 1987 Public Expenditure Survey. There were present the Lord President, the Chancellor of the Exchequer, the Chief Secretary and Mr. Richard Wilson (Cabinet Office).

The Chancellor of the Exchequer briefly described the overall picture along the lines set out in the note attached to Alex Allan's letter to me of 2 October. The Prime Minister congratulated the Chief Secretary on his achievements so far in the Public Expenditure Survey. The meeting then discussed in turn major programmes where agreement had not yet been reached.

The Chief Secretary explained the options for defence. One would be to settle a firm figure this year within which the Long Term Costing exercise would take place. Alternatively, an interim settlement could be reached now with a view to taking final decisions next year after the Long Term Costing had been completed. It would however be very difficult to reach agreement on a one stage option. A two stage option seemed more achievable, perhaps with some form of assurance on the financing of of pay increases for the armed services. This might be along the lines that the defence programme would absorb first year costs but the Treasury would take later year costs into account in the Public Expenditure Survey. It would be important in that event for MOD to give suitably firm evidence to the AFPRB. However, even with a two stage settlement, the defence programme might well need to go to the Star Chamber: the figure for the first year would need to be tough in order to set a firm framework for the Long Term Costing exercise, and Mr Younger would resist this.

The Prime Minister agreed that the defence programme should be taken to the Star Chamber if necessary. The choice between the options would have to be for the Chief Secretary's judgment. However he should bear in mind the need for the Secretary of State for Defence to achieve a settlement which would give assurance to the armed services. The wasteful procurement policies of the MOD and the slowness with which action was being taken on R&D showed the scope for better use of resources.

The Chief Secretary explained that education was the most likely candidate for the Star Chamber, though it was possible that Mr. Baker would settle beforehand. The Prime Minister urged the need to be very tough.

The Prime Minister said she had some sympathy with the bids for extra resources for health which had been entered by the Secretary of State for Social Services. All the signs were that a more fundamental examination of the provision of health care would be needed before too long. After discussion it was agreed that the possibility of withdrawing exemption from prescription charges for people between retirement age and the age of 80 should not be pursued, even though other exemptions on the grounds of low income and the like would still apply to them: this was not a proposal which would be readily accepted by Cabinet or by Government supporters in the House. It was further agreed that the choice of health bids to go to the Star Chamber should be considered with great care by the Lord President and the Chief Secretary. The Prime Minister asked to be kept closely in touch.

On the aid programme, the Prime Minister drew attention to a recent report from the European Court of Auditors which had agreed that aid resources were not reaching those for whom the aid was intended. There was no strong case for an increase in the aid programme and indeed the Foreign Secretary could find resources from the diplomatic wing if he wished to make such an increase. Any increase should be resisted.

The Chief Secretary explained that the Secretary of State for Scotland might accept a move from regional development grant to selective regional assistance if he felt that he could then have an easier settlement on Scottish block expenditure. The formula consequentials for Scotland this year were likely to be quite tough so this might well be an acceptable deal. The Secretary of State for Wales might accept the principle of the change but dispute the quantum of selective assistance.

It was agreed that the members of the Star Chamber, should be the Chief Secretary, the Secretary of State for Energy, the Lord Privy Seal, the Minister for Agriculture (if as expected his programme was soon settled) and probably the Secretary of State for Employment. The Chancellor of the Duchy of Lancaster would be an alternative to the Secretary of State for Employment. However, he could not easily be a member if Wales or Scotland were going to the Star Chamber over regional aid. If the Chancellor of the Duchy of Lancaster were not in the end to be a member, the Lord President should explain the reasons to him.

The Chief Secretary explained the position on the remaining major programmes. On electricity, the Prime Minister said that substantial increases in electricity prices would need to be justified by reference to the heavy programme of investment both in new power stations and in de-sulphurisation equipment, with the environmental benefits that would bring. It would cause difficulties for the Secretary of State for Employment, if, having accepted a tight settlement, others were now seen to fare better.

I am copying this letter to Mike Eland (Lord President's Office), Alex Allan (H. M. Treasury) and Richard Wilson (Cabinet Office).

Yrs,

David.

D. R. Norgrove

Ms. Jill Rutter,
HM Treasury.

PERSONAL

CONFIDENTIAL

Pup

FERB
TO
CST.
2OCT

FROM: F. E. R. BUTLER
2nd September, 1987.

CHIEF SECRETARY

c.c. Chancellor
Mr. Anson
Mr. Turnbull

MEETING WITH THE PRIME MINISTER AND LORD PRESIDENT: AIDE MEMOIRE ON STAR CHAMBER TACTICS

This is a note to remind you of what was agreed at the Chancellor's meeting this morning about our tactics for the Star Chamber candidates and bring it up to date following a further review this afternoon.

General

2. There remains a danger of too few substantial candidates for Star Chamber, particularly since Mr. Baker's bid is collapsing to the point where there may be little difference between your position and his - please see Mr. Gilmore's separate submission of this afternoon. Of those cases which go to Star Chamber, some - eg defence and aid - may well be settled outside. So there is a definite risk of the Star Chamber's work collapsing.

Defence

We will plan and make preparations to take defence to the Star Chamber. Mr. Younger may press you hard for a bilateral settlement.

Health

This seems a certain Star Chamber item, but I know you do not want it to be isolated.

Education

Again we will prepare for this to go to Star Chamber, but given that DES' position on local authority capital is collapsing you may have to be obdurate with Mr. Baker next week to avoid settling!

Scotland

You do not want Star Chamber to settle this and, following further consideration this afternoon, we think it better to advise you to settle it with Mr. Rifkind next week rather than even put a paper to Star Chamber. A brief will be coming forward on Monday evening, provided the meeting with the Prime Minister confirms this tactic.

Aid

We will prepare a paper for Star Chamber, but expect the Lord President to settle it in the margins with the Foreign Secretary.

Wales

We will hope that Mr. Walker's price for accepting the regional development package is so exorbitant that it will justify us taking it to Star Chamber.

3. It is just possible that Transport might provide another candidate, but Star Chamber would only be asked to adjudicate on relatively very small sums.

Conclusion

4. We will do our best to provide an adequate agenda for Star Chamber but, at worst, you could be left with only Health and Wales actually being settled by them.

F.E.R.B.

F. E. R. BUTLER

cc PPS

010/4207

SECRET

Prescription charges: line to take

John Moore and I have been considering a wide range of options for financing the large expansion of services which he naturally wants. A re-structuring of exemptions is just one of those options and there has certainly been no decision to adopt it. In fact, I think that John is moving against the idea of including it this year. But there could be quite an attractive political package made out of restricting exemptions to those in need and using the savings to finance an expansion of services. I hope you will not rule it out in principle until John has made a decision and shown you what he had in mind.

Covering **SECRET & PERSONAL**

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

ACSA
TO
NORGROVE
2 OCT

2 October 1987

David Norgrove Esq
No.10 Downing Street

Dear David,

SURVEY PROSPECTS

The Chancellor and Chief Secretary are meeting the Prime Minister and the Lord President on Monday to take stock of where the Survey has got to, the issues outstanding and to consider the next steps. ... I attach a copy of a note summarising this.

2. The meeting might like to take the questions in the following order:

i. the prospects for the overall outcome;

ii. the outstanding issues and the channels for resolving them;

iii. membership of the Lord President's Group;

iv. the starting date for its work.

3. I am copying this letter and attachment to Mike Eland in the Lord President's Office.

Yours,

Cathy Rydins.

pp **A C S ALLAN**
Principal Private Secretary

SECRET & PERSONAL

PROSPECTS FOR 1987 SURVEY

The overall picture

Cabinet agreed to hold as close as possible to the existing planning totals and certainly not to allow public spending to exceed the proportions of GDP set out in White Paper. It is important to emphasise the "as close as possible" condition and not allow colleagues to think in terms of an upper limit up to which we can spend.

2. The latest assessment is that we face increases in the planning totals of around £3 billion in 1988-89 and around £6 billion in 1989-90 (compared with £5 billion and £5¾ billion last year).

3. There may be scope for some increase in privatisation proceeds but while they may reduce the headline totals they will not help us with our declared aim of reducing spending as a proportion of GDP, where we have defined our objective as excluding privatisation proceeds, or with the markets who also set privatisation proceeds aside in making their assessments.

4. The figures assume larger Reserves than last year. These will be needed to cover uncertainties on contributions to the EC budget, overshoots on local authority spending and on social security, as well as genuine contingencies.

5. It is likely that the increases we face will be consistent with our objectives for public spending as a percentage of GDP. But the size of the cash increases and the growth in real terms (about 1½ per cent a year on average) will need very careful presentation.

Issues outstanding

6. The Chief Secretary has reached or is close to agreement on nearly all the nationalised industries and the majority of the programmes, but difficult issues remain in a number of areas.

7. Defence. Over the last two years MOD has done its programme planning (through the annual long-term costings) more or less without reference to their public expenditure provision. A large gap has opened up between the two. The Secretary of State has put forward bids of over £2 billion over the three years on an 'interim' basis while he completes the current costings exercise with a view to taking final decisions both on the programme and resources next year. He has asked for higher additions - some £2¾ billion - if his settlement this year was to be a full and final one.

8. The Chief Secretary considers increases of this order unjustified. He considers it desirable to establish a firm cash envelope for the current costings exercise and believes this can be done with much more modest additions by taking full account of the major savings from improved efficiency which should be possible. A gap of more than £1 billion over the three years remains

9. Health. Agreement has been reached for the Family Practitioner Service including the ways in which service improvements are to be financed (principally from the dental charges agreed in Cabinet). Disagreement remains on the Hospital Service over what extra resources should be made available and how they should be financed. A substantial gap remains of around £175 million in the first year rising to £500 million in the third.

10. Education. The Secretary of State has moderated his original bids, principally for science, universities and capital for local authority schools, by a total of £100 million a year; but at around £450 million in the first year, rising thereafter, they remain much too large. The Chief Secretary will be prepared to offer some additions, but a gap of more than £200 million remains in each year.

11. Wales. Agreement has been reached with DTI on a package which includes switching, from 1 April 1988, from Regional Development Grants in part to Regional Selective Assistance, and in part to advisory services in the regions. But the agreement

is conditional on the territories being prepared to follow the same course, which the Secretary of State for Wales is currently opposing. Even if he acquiesces he will be seeking compensating increases on which it may be difficult to reach agreement.

12. Scotland. Treasury believes there is massive over-provision relative to need - around £1 billion or 20 per cent of Scottish block - which is being perpetuated by the formula. Treasury has proposed making a start on reducing this, principally by making an adjustment to reflect recent trends in population distribution. Mr Rifkind is totally opposed to this. He is also seeking an extra £70 million to finance the higher local authority settlement in Scotland this year, money which would normally be found from the block. We have still to agree the consequences for Scotland of the regional policy proposals.

13. Aid. The Foreign Secretary is arguing for a policy decision to bring the Aid programme to a specified proportion of GNP (0.33 per cent). The Treasury has offered an amount which would be sufficient to hold it broadly constant in real terms (as was done in the last Survey) plus whatever is required to meet the Chancellor's debt initiative. By 1990-91 the gap is substantial, £230 million sought against £25 million (plus an assurance that the Treasury will meet the costs of the debt initiative) which has been offered. However, the Foreign Secretary has suggested further talks between the Chief Secretary and the Minister of Overseas Development though it is unlikely that he will be willing to resolve it without further involvement himself.

Next Steps

14. The Chief Secretary will have further bilateral discussions on education, health and defence either in London or in the margins of the Conference. He thinks it would be better to allow time for these to continue on the Monday and Tuesday after the Conference, with the Lord President's group beginning work on the Thursday (15 October). It is still hoped to bring the final proposals before Cabinet on 5 November.

SECRET AND PERSONAL

FROM: CATHY RYDING
DATE: 2 October 1987

MR TURNBULL

cc: CST
Sir P Middleton
Sir T Burns
Mr F E R Butler
Mr Anson
Mr Gieve
Miss Walker

SURVEY PROSPECTS: MEETING WITH PRIME MINISTER

The Chancellor was grateful for your minute of 2 October.

2. The Chancellor made a few amendments to the note for the Prime Minister and this has now been despatched. However, the Chancellor thought that the PS letter to Lord Whitelaw should not be sent. He thinks this is far better covered by him orally: either at the Prime Minister's meeting or subsequently.

CR

CATHY RYDING

2131/16

FROM: A TURNBULL
DATE: 1 OCTOBER 1987

CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Monck
Mr Scholar
Mr Gieve
Mr Culpin
Mr Pickford
Miss Walker

TURNBULL to CST 1/10

ESTABLISHMENT OF STAR CHAMBER

I have now spoken to No 10 Private Office and have agreed with them the line to take on the establishment of the Star Chamber. He agreed that, in order to counter the stories in the Independent that the Survey was proving so easy that Star Chamber would not be needed, the following message should be communicated as soon as possible:

> "As has been the practice in recent years, a group of Ministers under the chairmanship of the Lord President, will be established to consider any outstanding issues."

2. It was agreed that this should issue, in the first instance, from the No 10 Press Office but that it should then be followed up from here.

3. Possible supplementaries are:

<u>What are the issues?</u>
Not yet known as bilateral discussions are still continuing.

<u>Who will be the members?</u>
Not decided until it is known who has settled.

<u>Was public expenditure on the Cabinet agenda today?</u>
No.

4. I discussed with Mr Norgrove the way in which the establishment of the Group should be made known to other members

of Cabinet. He is proposing to send a short reply to the Chief Secretary's minute of 29 September saying that the Prime Minister has noted the Chief Secretary's report and will be asking the Lord President to chair a group.

AT

A TURNBULL

pubexp folder

10 DOWNING STREET
LONDON SW1A 2AA

From the Private Secretary 1 October 1987

Dear Jill,

1987 PUBLIC EXPENDITURE SURVEY

The Prime Minister has seen the Chief Secretary's minute of 30 September about the progress of the public expenditure survey. In the light of this, the Prime Minister will now be establishing a small group, under the Chairmanship of the Lord President, to consider the outstanding issues and to make recommendations to Cabinet.

I am sending copies of this letter to other members of the Cabinet and to Eleanor Goodison (Office of the Arts and Libraries) and to Trevor Woolley (Cabinet Office).

Yours,

David.

D. R. Norgrove

Ms. Jill Rutter,
H. M. Treasury.

No10 to PS/CST 1/10

003/3008

CC - CX, Sir P Middleton
Mr Butler, Mr Turnbull
Mr Anson, Mr Monck
Mr Scholar, Mr Gieve
Miss Walker

CONFIDENTIAL

CST to PM 30/9

FROM: CHIEF SECRETARY

DATE: 30 September 1987

Cabinet folder

PRIME MINISTER

1987 PUBLIC EXPENDITURE SURVEY

At its meeting on 23 July, Cabinet endorsed the objectives of ensuring not only that the level of public expenditure should be held as close as possible to the existing planning totals, but also that its share of national income, without allowing for privatisation proceeds, should not exceed the path in the previous year's White Paper. I was asked to conduct bilateral discussions against these objectives.

2. I have now had at least one discussion with nearly all colleagues and it has been possible to make a substantial degree of progress in reducing the number of outstanding issues. Agreement has been reached on over half of the nationalised industries and discussions are continuing on the rest. A number of departmental programmes have been settled or are close to settlement. I will be continuing discussions with those colleagues over the next few days. However, it is clear that on some programmes difficult issues remain.

3. At the Cabinet discussion in July it was envisaged that, if it was impossible to reach agreement on all programmes bilaterally, you would establish a small group, under the chairmanship of the Lord President of the Council, to consider the outstanding issues and make recommendations to Cabinet. You may feel that it would now be appropriate to establish such a group so that it could begin work after the Party Conference on any questions which by then are still unresolved.

4. As in previous years, I will ensure that the outcome on all programmes and the main policy changes involved are reported to Cabinet at the end of the Survey.

5. I am sending copies of this minute to Cabinet colleagues, Richard Luce and to Sir Robert Armstrong.

John M.

JOHN MAJOR

2131/8

CONFIDENTIAL
Covering SECRET

TURNBULL to CST 30/9

FROM: A TURNBULL
DATE: 30 SEPTEMBER 1987

CHIEF SECRETARY

C/ All of the minutes of PES bilaterals etc are in CST bilateral folder
CR 30/9

cc Chancellor
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Monck
Mr Luce
Mr Gieve
Mr Hansford

BRIEFING FOR CABINET

I attach some briefing material for tomorrow's Cabinet meeting. This covers:

i. report on the bilaterals - Annex A;

ii. procedure for setting up Star Chamber - Annex B;

iii. possible arguments from colleagues on the scope for increasing the planning totals - Annex C;

iv. running costs - Annex D.

2. You will also want to have with you:

i. the latest scorecard; — behind; and see also 'endgame' note, and running costs state of play, in same folder.

ii. the minutes of the 23 July Cabinet. — behind.

AT

A TURNBULL

ANNEX A

REPORT ON BILATERALS

Background

Categorising programmes into settled, not settled but expected to be, disagreed, is not straightforward. Some of the settled programmes are conditional upon the agreement of other colleagues eg DTI. In the case of Social Security we do not want to advertise the fact of an agreement and thereby provoke enquiries into its nature. Appendix A attached summarises the position in each case.

Line to take

2. (i) I have now agreed EFLs for most of the nationalised industries and for several of the programmes I have reached or am very close to agreement. Nevertheless it is likely that some difficult issues will remain unresolved.

(ii) [If asked to go into detail on particular settlements] As I indicated in my minute to the Prime Minister, details of proposed policy changes, whether agreed in bilaterals or recommended by Star Chamber will be reported to colleagues.

(iii) [On income related benefits] - principally for Mr Moore to defend but points to make at Appendix B.

Appendix A

POSITION OF SURVEY DISCUSSIONS

Defence: Following your third bilateral on Tuesday, officials are preparing a note setting out the current Treasury and MOD offers on both a "one stop" and "two stop" settlement. You plan to have a word with Mr Younger in Blackpool next week before deciding whether to refer this to Star Chamber.

FCO: You have written to Sir Geoffrey endorsing the provisional agreement negotiated by officials on the diplomatic wing and repeating your offer on aid. We await his response. It seems probable that he will seek to reopen at least some aspects of the diplomatic settlement and that he will approach the Lord President on aid.

EC: EC division are still working on their revised projections. This will be the subject of a separate submission next week.

Agriculture: You are meeting Mr MacGregor tonight. A settlement should be possible.

DTI: You have reached agreement on both DTI and ECGD subject to approval of Lord Young's policy proposals on regional aid and approval for legislation. The potential complications on this front are discussed in my separate minute of today. You have also reached agreement on DTI's nationalised industries.

Energy: Mr Parkinson is meeting Jones, Haslam, and Area Board Chairman today and tomorrow to try and finalise the settlement you have agreed with him. It is still possible that some part of this could come unstuck but the prospects are good. You have agreed his departmental programmes.

Employment: You are meeting Mr Fowler again this evening and hope to reach a settlement.

Transport: As a result of your revised proposals on local authority allocations, it should be possible to clear a settlement by correspondence this week. A deal has been agreed on the nationalised industries.

Environment: You have reached agreement on all Mr Ridley's programmes.

Home Office: Following your letter to Mr Hurd officials have reached agreement subject to your (and his) approval. A submission is being put up tonight.

Lord Chancellor's Departments: You have agreed figures for this programme subject to agreement on tape recording with the Home Secretary.

Education: You made some further progress at your bilateral on Tuesday and are due to meet Mr Baker again on Thursday. It still seems likely that he will go to Star Chamber but not certain.

Arts: Mr Luce has written proposing a three year deal. HE will be submitting advice tonight recommending that you make a counter offer. A settlement seems likely.

Health:

You are meeting Mr Moore this afternoon to put a revised offer to him. It seems unlikely that you will reach a settlement. If not you will decide whether to refer to Star Chamber after your meeting with the PM.

Social Security:

You have reached agreement on benefits. There are some outstanding points on administration but a settlement should be possible on these in due course.

Scotland:

You are duc to meet Mr Rifkind on Thursday to discuss his industry bids, his electricity boards and running costs. He has made it plain that he will resist any measures on the block. He is a leading candidate, therefore, for Star Chamber.

Wales:

You are due to meet Mr Walker on Friday for a first run over the ground. This is still a potential candidate for Star Chamber.

Northern Ireland:

You have concluded a settlement with Mr King.

Chancellor's Departments:

We have put a submission to you on the small departments. You are due to respond in due course to the Inland Revenue and Customs and Excise on their bids. Sir P Middleton will be minuting the Chancellor on the Treasury itself separately.

Other department's:

We will be putting a second omnibus submission on other small departments to you very shortly.

Local Authority Relevant:

LG will be submitting this week a letter for you to send to other local government departments proposing figures and a service distribution for 1988-89 and 1990-91. This should be settled in correspondence.

SECRET

Appendix B

SOCIAL SECURITY

	1988-89	1989-90	1990-91
			£m
Present Plans	47,300	49,100	50,400
Bids	1,400	1,950	3,500
Savings	250	270	270
Net change*	1,150	1,680	3,230

* reflects administration settlement but before changes due to revised economic assumptions and any consequentials from settlement on DE programme.

Defensive

(1) Savings on "illustrative" rates for new benefits incompatible with pledge on 20% rates compensation. No commitment to add £1.30 to illustrative rates.

(2) Too many losers; presentational advantages of E(LF) decision on rates compensation lost. No gainer/loser figures announced since Technical Annex. Picture now (3.6m gainers, 4.6m losers) better than Technical Annex (2.2m gainers, 3.8m losers). And 2.1m losers on Income Support - the poorest - protected by transitional protection (cost £200m in 1988-89).

(3) Higher housing benefit rent taper bad for incentives. Net effect on poverty trap minimal. Marginal tax rate (mtr) of approx 90,000 working families will rise, but mtr of approx 50,000 will fall (because floated off benefit). Preliminary calculations suggest that number (450,000) with mtr's over 70% (conventional definition of poverty trap) will be almost unchanged.

Higher taper will worsen unemployment trap but offset by lower benefit rates which will improve trap. Net effect marginal.

(4) Higher taper will prevent move to market rents. No:taper relates to income of tenant, not rent level, and from 1988 all tenants above Income Support level will receive 100% help with rent increases. Higher taper prevents HB going to better off.

(5) Savings too harsh on poor. Must be seen in context of proposed expenditure on reform benefits (Income Support, Housing Benefit, Family Credit) of approx £13bn. No savings on other benefits for pensioners or sick and disabled. Still huge addition to programme.

ANNEX B

PROCEDURE FOR REMAINING STAGES OF SURVEY

Background

The Prime Minister has been briefed to raise orally the Chief Secretary's minute on the bilaterals. She will say that she intends to establish a group under the Lord ~~Chancellor~~ President, to start work after the Party Conference. She will not invite any further discussion of the Survey. If asked about membership she will be briefed to say that she will decide that later in the light of who has settled and is thereby available. Other points that might be raised:

i. date of next discussion on public expenditure? Probably 5 November, but depends on progress of Star Chamber;

ii. date of Autumn Statement? Not yet settled. [A decision will be needed on whether to make the Statement in the afternoon of the Cabinet meeting or whether to revert to earlier timetable of Tuesday in the following week.]

ANNEX C

SCOPE FOR INCREASING THE PLANNING TOTAL

Background

It is possible that colleagues may argue that:

i. there is substantial scope for increasing the planning totals given the higher growth of money GDP;

ii. that they need to be given information on this so that they can make their own judgements about what can be afforded for their proposals.

We know that DES officials have been probing on these lines.

2. On (i), colleagues are aware that money GDP figures in the MTFS are higher than those on which the PEWP ratios for GGE/GDP were calculated. Applying the PEWP ratios to the new level of GDP produces levels of GGE that are approximately £2¼ billion higher in 1988-89 and £3¼ billion in 1989-90. Colleagues are also aware that real growth in 1987-88 is likely to exceed the 3 per cent in the FSBR, increasing the scope still further. Outside commentators have suggested figures in the range of £2-4 billion.

3. On (ii), the argument is one of propriety - that colleagues are entitled to have the information needed to interpret the Cabinet remit.

Points to make

4. (i) Important to be clear about objectives agreed in July. Cabinet minutes record Chief Secretary as proposing:

> "the Government's objective, based on its Manifesto commitment, must be to ensure not only that the level of public expenditure should be held as close as possible to the existing planning totals, but also that its share of national income, without allowing for privatisation proceeds, should not exceed the path in the previous year's White Paper."

The Prime Minister's summing-up said:

> "that the Cabinet endorsed the proposals by the Chief Secretary."

Thus objective is to get as close as possible in previous totals, not simply to calculate a limit and then spend up to it.

(ii) Essential to retain confidence of financial markets. With markets concerned about overheating essential to keep any increase as low as possible.

(iii) An increase in money GDP is the current year could not automatically be carried through into the level of money GDP in 1989-90 and 1990-91, which is what is relevant for setting medium-term objectives. Faster real growth now could be offset by a period of slower growth. And if increase were because inflation was higher, there was no presumption that expenditure should be increased pari passu - indeed some tightening might be appropriate.

(iv) Government has consciously and successfully adopted policy of planning on a cautious assumption of the resources likely to be available. This had left something in hand to cope with shocks.

(v) Cannot say what forecast of money GDP will be - is being worked on now.

(vi) [If pressed on when colleagues will be told] At the end of the Survey Chancellor will put to colleagues proposals on the new planning totals which take account both of the negotiations in bilaterals and Star Chamber and of the economic outlook.

ANNEX D

RUNNING COSTS

Line to take (But only if raised by others)
On running costs, it has not been easy to keep settlements to levels consistent with the objectives we set ourselves. The overall outcome will depend on one or two large departments which are still unsettled. If those cases can be settled satisfactorily, I hope that the result will not be out of proportion to the outcome of the Survey generally.

Background
2. On 23 July the Cabinet agreed your proposals that:

a. the aggregate running cost bids in 1988-89 should be reduced by at least half;

b. all departments should prepare management plans that deliver efficiency savings of at least 1½ per cent;

c. the share of total running costs within total public expenditure should not rise over the Survey period.

3. We still do not have many final settlements on running costs in this Survey. Whilst many bids have been halved, and some reduced still further, volume increases and supplementary bids mean that the aggregate is likely to be closer to two thirds of the bids.

4. Not unexpectedly, many departments have had diffiulcty in putting together robust management plans to meet the Cabinet's mandate in time for this Survey. Indeed, on the latest showing some 20 departments still have to submit their plans. Since granting firm 3-year settlements to departments before they qualify for the privilege could only undermine Cabinet's objective, we have to accept that you will only be able to reach settlements covering the full Survey period with a handful of departments this year. But the ground work is laid for next year's round to be a far more business-like operation.

5. The relationship between total running costs and total public expenditure is expected to remain broadly stable next year, and (because of the lack of 3-year settlements) to be understated in the later years. The final ratio will, of course, depend equally upon changes in the planning total.

6. On Civil Service numbers, the projected outcome on running costs suggests that the 1.4.89 figure will be some 8,000 above that published in last year's White Paper, though it is too early to be sure.

RUNNING COSTS POSITION

CONFIDENTIAL

FROM T R H LUCE
30.09.87
Room 55/G
Ext 4544

CHIEF SECRETARY

cc Chancellor
Miss Rutter
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Turnbull
Mr Gieve
Mr Hansford
Mr Hoare/Mr Binns
Mr Cropper
Mr Tyrie
File A
File B

PES 1987: RUNNING COSTS POSITION

1 This is a summary of the probable overall running costs outcome.

1988-89

2 Last week's scorecard (copy attached again) showed a forecast outcome as follows:

£m

	1987-88	1988-89
Baseline	13041	13315
Likely additions		510
Totals (% cash increase)	13041	13825 (6.0%)

3 There are still some significant uncertainties more likely to be resolved for the worse than the better. The MOD position is still quite unclear. They are pressing strongly for a larger increase than the £99 million still assumed in the scorecard. The DTI allocation between programme and running costs will be deferred

until after the Survey, but will probably lead to higher running costs than now assumed. And we may have to accommodate some £30 million additional running cost expenditure on Government estate maintenance. The outcome will probably be an increase over the 1987-88 baseline of between 6% and 6½% (representing a real increase of 2%-2½%). In-year increases may enable us to keep it down to 6%, or even below that if large 1987-88 increases (e.g. for MOD) have to be conceded.

4 If in-year increases bring the 1987-88 to 1988-89 growth to significantly less than 6% we shall probably be able to claim that it is broadly in line with the increase in total spending which, depending on the aggregate chosen, is likely to be in the range 5.5% to 5.9%.

5 We had not expected to achieve reductions of the running cost bids by the 50% mentioned as an objective in your PES Cabinet paper; and would have been surprised (if pleased) to meet the third criterion of 1% real growth.

6 But the likely outcome does imply an underlying real growth trend of 2% a year. This is entirely consistent with internal medium-term forecasts we made before the Survey started, though it is higher than we would like and if continued for a long period might imply a rising running cost share in public spending.

7 Nevertheless, departments have been put under real pressure - a third of the total bid for has been rejected (a much larger proportion than last year); and we have had to accommodate two factors which tend to push up the total:

(i) realistic pay provision, at levels of departments' own choice. We have deliberately refrained, this year, from "talking down" their pay assumptions (though generally speaking these do not seem to have been particularly high)

(ii) rising forecasts of estate costs.

There has also been a sizeable increase in manpower.

8 We do not yet have a detailed breakdown of year-on-year changes by department. But amongst the departments with which settlements significantly above the average have been reached or are foreseen, are Inland Revenue, LCD, Customs, MAFF, IBAP, Scottish Office, DTI, Energy, the Crown Prosecution Service and the OPCS. You will have noted from Mr Gieve's submission of yesterday that the average year-on-year increase for the Chancellor's departments will be 8.8%.

Later Years

9 We recognised at the outset that agreeing "final" later year provision for all departments on the basis of decent three-year management plans would need two Surveys. We do not have full details by department, but at present the picture is:

- 19 of the 49 departments covered in the Survey have so far produced three-year plans, and ten of these are judged to meet the 1½% minimum annual efficiency gain commitment

- the large majority of these departments are likely to get full three-year settlements. They include FCO, IBAP, Energy, Transport, Customs and the LCD

- the others (including all the really large departments except Customs) will have no proper later year settlements. The temporary provision agreed for them differs somewhat between individual cases. Some will be left with unaltered baselines (PSA, Treasury); for others some essential provision has been knocked-forward. But in few if any cases will the later year increases exceed the forecast GDP deflator change; and in all the unsettled cases there will be a definite restriction of provision.

10 It follows that, as predicted, the aggregate running cost figures for the later years are unrealistically low. In his recent submission on the Survey end-game Mr Gieve has noted the likely consequences for the Reserve.

Tor.

T R H LUCE

CONFIDENTIAL

ANNEX A

Position on running costs and manpower in the Survey - as at close on 23 September

Running Costs	1987-88	1988-89	1989-90	1990-91
Baseline	13041	13315	13681	14023
DEPARTMENTS POSITION		762	992	1257
Year on year % increase if bids accepted		7.9	4.2	4.1
HMT'S POSITION		152	135	197
Year on year % increases if aims achieved		3.3	2.6	2.9
Forecast Outcome		**510**	**516**	**608**
Year on year % increase if forecast outcome achieved		6.0	2.7	3.1
GDP Deflators		4.0	3.5	3.0

Manpower	1.4.88	1.4.89	1.4.90	1.4.91
Plans in last PEWP (Cm 56)	590,400	582,800	583,700	[583,700]
1987 Survey baseline	588,000	581,600	583,300	583,300
(Ø Trading Funds and exempted areas	8,300	8,200	8,000	8,000)
DEPARTMENTS POSITION	8,089	13,112	13,953	15,341
Baseline and bids	596,089	594,712	597,253	598,641
Increase over Cm 56	5,669	11,902	13,553	14,941
HMT'S POSITION	5,856	5,996	6,000	7,444
Baseline and aims	593,856	587,596	589,300	590,744
Increase over CM 56	3,456	4,796	5,600	7,044
Forecast Outcome	5,851	7,936	7,933	8,087
Baseline & Forecast Outcome	**593,851**	**589,536**	**591,233**	**591,387**
Increase Over Cm 56	3,451	6,736	7,533	7,687

Notes

Ø Both the plans in Cm 56 and the Survey baseline include staff in Trading Funds and other areas of central government activity exempted from gross running costs control

Comment Essential to reduce bids for extra manpower (and associated running costs) if downward trend in manpower numbers is not to be reversed.

CONFIDENTIAL Date of print: 25/09/87

SUMMARY SCORECARD

RUNNING COSTS (£m)

DEPARTMENT	1988-89 BASELINE	1988-89 DEPT POSITION	1988-89 HMT POSITION	1988-89 FORECAST OUTCOME	1989-90 BASELINE	1989-90 DEPT POSITION	1989-90 HMT POSITION	1989-90 FORECAST OUTCOME	1990-91 BASELINE	1990-91 DEPT POSITION	1990-91 HMT POSITION	1990-91 FORECAST OUTCOME
MOD	5,265.677	221.000	0.000	99.323	5,397.267	341.000	0.000	130.291	5,532.199	438.000	0.000	148.272
ODA	39.944	3.580	2.380	2.380	39.500	2.610	1.695	1.805	40.488	2.000	1.055	1.165
FCO	406.927	2.050	1.800	1.800	417.070	4.010	3.800	3.800	427.496	2.610	2.400	2.400
MAFF	223.237	15.100	0.000	9.000	231.131	17.200	0.000	0.000	236.909	20.900	0.000	0.000
IBAP	10.934	4.400	4.000	4.200	11.023	4.500	4.000	4.300	11.299	5.200	4.500	5.000
DTI	285.570	12.600	0.000	10.000	293.528	14.200	0.000	10.000	300.866	17.900	0.000	15.000
Energy	27.179	1.270	1.270	1.270	27.842	7.619	7.619	7.619	28.539	7.556	7.556	7.556
DEmp Group	910.466	77.442	20.434	51.500	937.580	73.863	16.320	51.400	961.020	76.662	19.180	55.000
DTp	266.741	9.000	0.000	6.500	276.099	9.700	0.000	6.700	282.998	11.100	0.000	8.200
DoE	154.208	0.310	0.310	0.310	157.674	-2.650	-2.650	-2.650	161.616	-2.715	-2.715	-2.715
HO	801.241	11.000	0.000	11.000	820.789	9.800	0.000	9.800	841.309	8.650	0.000	8.650
LCD *	200.227	10.000	10.000	10.000	209.414	14.000	14.000	14.000	214.650	20.000	20.000	20.000
DES	60.133	10.300	0.000	3.900	61.551	13.300	0.000	5.100	63.090	18.110	0.000	5.000
OAL	1.305	0.250	0.050	0.125	1.337	0.250	0.050	0.125	1.371	0.250	0.050	0.125
DHSS (SS)	1,563.565	168.700	38.000	139.000	1,602.877	190.400	0.000	124.000	1,642.949	234.900	0.000	137.000
DHSS (H)	73.671	5.507	2.100	3.900	75.650	8.660	4.700	6.500	77.541	12.238	6.900	8.800
Scot Off	113.612	4.148	0.600	2.257	116.901	5.721	0.000	0.000	119.823	7.335	0.000	0.000
Scot Off (Prison)	62.100	17.660	9.900	10.400	62.623	21.151	10.200	10.800	64.189	24.750	10.800	11.500
SCA	20.366	2.623	2.623	2.623	21.010	3.111	0.000	0.000	21.535	3.602	0.000	0.000
SRO	2.195	0.226	0.000	0.117	2.260	0.239	0.000	0.000	2.316	0.264	0.000	0.000
GRO (S)	4.216	0.904	0.437	0.437	4.320	1.366	0.836	0.836	4.428	3.058	2.595	2.595
DRS	11.907	1.480	0.000	0.900	12.313	0.998	0.000	0.000	12.626	1.077	0.000	0.000
Welsh Office	38.999	1.980	0.000	0.487	39.960	2.492	0.000	0.000	40.959	3.365	0.000	0.000
NI Civil Service	492.227	21.100	0.000	16.800	506.993	26.416	0.000	0.000	519.667	37.528	0.000	0.000
COI	21.018	-0.300	-0.300	-0.300	21.484	-0.041	-0.041	-0.041	22.021	0.065	0.065	0.065
C & E	438.624	34.270	13.900	20.800	447.341	55.706	22.700	33.700	458.525	74.624	32.300	45.500
RFS	3.602	0.271	0.000	0.257	3.692	0.272	0.000	0.258	3.784	0.273	0.020	0.259
GAD	2.084	0.231	0.231	0.231	2.137	0.358	0.358	0.358	2.191	0.423	0.423	0.423
IR	1,011.660	85.600	15.040	65.000	1,045.390	118.400	27.410	69.000	1,071.525	150.100	44.175	76.300
DNS	160.623	0.000	0.000	0.000	164.632	0.000	0.000	0.000	168.748	0.000	0.000	0.000
NILO	1.229	0.077	0.077	0.077	1.259	0.086	0.000	0.000	1.291	0.097	0.000	0.000
HMTsy	68.026	0.819	0.000	0.819	69.709	2.017	0.000	0.000	71.452	3.790	0.000	0.000

MPO	30.430	0.864	-1.000	0.500	31.081	1.061	-1.000	0.055	31.803	1.425	-0.945	0.055
Cab Off	18.500	1.324	1.324	1.324	20.010	1.532	1.532	1.532	20.496	1.589	1.589	1.589
CC	6.232	0.522	0.522	0.522	6.464	0.285	0.000	0.000	6.626	0.588	0.000	0.000
LR	98.821	18.009	18.009	18.009	108.900	13.850	13.850	13.850	111.622	17.146	17.146	17.146
OS	53.171	3.355	0.000	1.750	54.500	3.355	0.000	0.000	55.863	3.355	0.000	0.000
PGO	14.695	0.442	0.000	0.442	15.511	0.538	0.000	0.538	15.899	1.034	0.000	1.034
PCO	1.188	0.000	0.000	0.000	1.218	0.061	0.061	0.061	1.249	0.425	0.385	0.425
PRO	11.309	0.636	0.263	0.263	11.579	0.954	0.000	0.000	11.868	1.147	0.000	0.000
OFT	8.470	1.691	0.000	0.000	8.675	1.183	0.000	0.000	8.892	1.382	0.000	0.000
OFGAS	1.790	0.000	0.000	0.000	1.840	0.000	0.000	0.000	1.886	0.000	0.000	0.000
OFTEL	3.666	1.241	0.000	1.241	3.757	1.403	0.000	1.403	3.851	0.926	0.000	0.926
PSA	132.000	0.900	0.600	0.900	134.800	2.200	0.000	0.000	138.200	3.200	0.000	0.000
OPCS	36.094	1.048	1.048	1.048	37.811	3.028	3.028	3.028	38.756	14.191	14.191	14.191
Cr Off	18.014	0.610	0.510	0.510	18.722	0.715	0.000	0.000	19.190	0.929	0.000	0.000
NI Ct Serv	10.829	0.962	0.844	0.844	11.080	1.364	0.000	0.000	11.360	1.779	0.000	0.000
CPS	112.092	3.070	2.800	3.000	118.569	9.710	6.500	7.500	121.533	19.460	15.000	16.500
SFO	2.500	2.620	2.620	2.620	2.500	2.090	0.170	0.170	2.563	2.477	0.180	0.180
TSol	11.225	1.559	1.495	1.495	11.504	1.983	0.000	0.000	11.792	2.132	0.000	0.000
TOTALS	13,314.539	762.451	151.887	509.581	13,680.877	992.066	135.138	515.838	14,022.869	1,256.897	196.850	608.141

Notes: * in column 2 indicates agreed bid

FCO bid does not include OPM effect (-£9.1m pa)

CONFIDENTIAL   Date of print: 24/09/87

SUMMARY SCORECARD

MANPOWER

DEPARTMENT		1.4.88 DEPT POSITION	1.4.88 HMT POSITION	1.4.88 FORECAST OUTCOME	1.4.89 DEPT POSITION	1.4.89 HMT POSITION	1.4.89 FORECAST OUTCOME	1.4.90 DEPT POSITION	1.4.90 HMT POSITION	1.4.90 FORECAST OUTCOME	1.4.91 DEPT POSITION	1.4.91 HMT POSITION	1.4.91 FORECAST OUTCOME
MOD		0	0	-500	0	0	-1,500	0	0	-2,000	0	0	-2,000
ODA		10	0	0	10	0	0	10	0	0	10	-5	-5
FCO		0	0	0	0	0	0	0	0	0	0	0	0
MAFF		183	0	0	175	0	0	196	0	0	201	0	0
IBAP		84	56	84	182	105	182	183	101	183	226	103	226
DTI		30	-146	0	45	-131	0	60	-116	0	60	-116	0
Energy		10	10	10	10	10	10	10	10	10	10	10	10
DEmp Group		2,757	1,344	1,644	3,009	1,317	1,867	2,614	1,073	1,623	3,056	1,288	1,838
DTp		0	0	0	64	-100	35	76	-100	35	92	-100	45
DoE		18	0	0	18	0	0	18	0	0	18	0	0
HO		202	0	0	308	0	216	312	0	120	312	0	120
HO (Prison Dept)		0	0	0	0	0	0	0	0	0	0	0	0
LCD	*	-200	-200	-200	-150	-150	-150	-100	-100	-100	0	0	0
DES		123	60	80	133	60	80	125	60	80	125	60	80
OAL		9	2	5	9	2	5	9	2	5	9	2	5
DHSS (SS)		4,043	4,043	4,043	4,077	3,050	4,077	4,520	3,050	4,520	2,886	2,886	2,886
DHSS (H)		-91	-91	-91	-60	-60	-60	-51	-51	-51	-28	-28	-28
Scot Off		0	0	0	207	0	100	227	0	0	309	0	0
Scot Off (Prison)		142	142	142	610	142	200	768	211	270	962	287	345
SCA		5	5	5	5	0	5	5	0	0	5	0	0
SRO		15	0	3	15	0	3	12	0	0	14	0	0
GRO (S)		41	32	32	71	40	40	86	72	72	94	90	90
DRS		0	0	0	21	0	0	21	0	0	21	0	0
Welsh Office		37	0	-15	37	0	25	25	0	0	25	0	0
NI Civil Service		22	0	10	22	0	10	22	0	10	22	0	10
COI		-50	-50	-50	-50	-50	-50	-50	-50	-50	-50	-50	-50
C & E		0	0	0	410	170	250	653	333	453	1,183	703	903
RFS		0	0	0	0	0	0	0	0	0	0	0	0
GAD		-6	-6	-6	-2	-2	-2	0	0	0	0	0	0
IR		0	0	0	1,798	0	802	1,967	0	998	2,683	0	998
DNS		0	0	0	0	0	0	0	0	0	0	0	0
NILO		0	0	0	0	0	0	0	0	0	0	0	0
HMTsy		0	0	0	0	0	0	0	0	0	0	0	0
MPO		0	0	0	0	0	0	0	0	0	-10	-10	-10
Cab Off		6	6	6	6	6	6	6	6	6	6	6	6

CC	3	3	3	6	3	3	10	0	0	10	0	0
LR	500	500	500	1,245	1,245	1,245	850	850	850	1,100	1,100	1,100
OS	0	0	0	-2	-50	-2	18	-50	0	38	-50	0
PGO	0	0	0	0	0	0	0	0	0	21	21	21
PCO	0	0	0	0	0	0	0	0	0	0	0	0
PRO	13	6	6	36	6	6	42	6	6	48	6	6
OFT	41	0	0	28	0	0	33	0	0	33	0	0
OFGAS	0	0	0	0	0	0	0	0	0	0	0	0
OFTEL	0	-2	-2	0	-2	-2	0	-2	-2	0	-2	-2
PSA	130	130	130	90	0	0	103	0	0	103	0	0
OPCS	37	37	37	49	49	49	209	209	209	509	509	509
Cr Off	0	0	0	4	4	4	4	4	4	4	4	4
NI Ct Serv	not in mp count											
CPS	-7	-7	-7	690	350	500	970	500	700	1,242	750	1,000
SFO	-7	-7	-7	-3	-7	-7	1	-7	-7	5	-7	-7
TSol	-11	-11	-11	-11	-11	-11	-11	-11	-11	-13	-13	-13
TOTALS	8,089	5,856	5,851	13,112	5,996	7,936	13,953	6,000	7,933	15,341	7,444	8,087

Note: * in column 2 indicates agreed bid

NP

1236/47

FROM: MARK CALL
DATE: 1 OCTOBER 1987

CHIEF SECRETARY

cc PS/Chancellor
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Miss O'Mara
Mr Cropper
Mr Tyrie

MANUFACTURING INDUSTRY

Please note that on the advice of EB I have made minor amendments to wording of my minute of 25 September which could be important if any of these statistics are for public consumption. An update is attached.

pp MARK CALL

ENC

1236/39

FROM: MARK CALL
DATE: 1 OCTOBER 1987

CHIEF SECRETARY

cc PS/Chancellor
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Cropper
Mr Tyrie

MANUFACTURING INDUSTRY

You asked me to pull together the basic facts on the state of the manufacturing sector. Sources other than the TWEB are indicated in parenthesis.

2. GDP growth

- Seventh successive year of steady growth at annual average rate of almost 3 per cent.

- Since 1980 UK has grown faster on average than other major EEC countries. Over previous 2 decades UK was bottom of growth league.

1960-70	1970-80	1980-86
Italy	France	**UK**
France	Belgium	Italy
Belgium	Netherlands	France
Netherlands	Italy	Germany
Germany	Germany	Belgium
UK	**UK**	Netherlands

3. Manufacturing output

- Manufacturing output in latest 3 months 5.9 per cent higher than same period a year earlier.

- Manufacturing output is now about the same level as in 1979H1; and in latest 3 months 19 per cent above the 1981 H1 trough.

- The new peak is still 2 per cent below the peak in the first half of 1974 (The Guardian).

- According to the CBI, manufacturing output compares poorly internationally. In the 10 years to 1986 output has changed as follows:

UK	-2%
Japan	+56%
US	+34%
Germany	+18%
Italy	+15%
France	+5%

- The CBI Survey, however, indicates good prospects for manufacturing output. Their Survey asks firms whether their order book is above normal, normal, or below normal. For the past 8 months the balance on total orders has indicated a positive balance. On only one occasion between April 1977 and January 1987 was it positive. (CBI)

- The balance on the export order books has fallen from the record levels of June and July. Despite the disappointing trade figures, the August balance is still positive and has only been bettered on 5 other occasions since the question was first asked in its present form in April 1977 (CBI).

4. Manufacturing productivity

- Manufacturing productivity in latest 3 months is up 7¼ per cent on the same period a year earlier.

- In latest 3 months it is up 38 per cent since 1979.

- Since 1980 manufacturing productivity growth has been greater in the UK than in all major countries. The table below indicates the annual average percentage change in output per head in manufacturing.

Country	1960-70	1970-80	1980-86
UK	3.0	1.6	5.1
US	3.4	3.0	4.0
Japan	8.8	5.3	2.4
Germany	4.1	3.2	2.6
France*	4.8	3.0	2.7
Italy*	6.7	3.1	2.4
Canada	4.0	3.2	3.4
Major 7	6.1	2.9	3.3

* Whole industry, not just manufacturing

5. Average earnings

- Average earnings in manufacturing are up 8.25 per cent (underlying) in the 12 months to July 1987 (cf 7.75 per cent for whole economy and 4.4 per cent for inflation).

- Average earnings are up partly because overtime is at peak levels. Overtime working is now a little above the peak level of some 12 million hours a week which was maintained throughout 1985.

- Real average earnings are up 21½ per cent since 1978-79.

6. Unit labour costs

- Unit labour costs have risen by a smaller percentage than average earnings due to productivity increases: 2.1 per cent between 1986Q1 and 1987Q1.

- Unit labour costs are, however, increasing more slowly than at the beginning of 1986.

- The change in unit labour costs in the UK does not compare favourably with that of the other major countries:

Country	%age Change 1986Q1-87Q1
UK	2.1
US	-1.1
Japan	-0.2
Germany	5.4
France	0.2
Italy	4.6
Canada	1.1
Major 7	0.7

Source: IMF

- However, for the first time since 1983 unit labour costs in the UK are expected to rise no faster than in other major industrial nations.

7. Manufacturing employment

- In July 1987, 5,068,000 people were employed in manufacturing, 63,000 fewer than 12 months before (-1.2 per cent).

MARK CALL

ds24

1 Andrew
2 PWP

FROM: D SAVAGE
DATE: 1 October 1987

MR CALL

cc: PS/Chancellor 12/2
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Mr Cropper
Mr Tyrie

MANUFACTURING INDUSTRY

Your minute of 29 September to Mr Colenutt asked why unit labour costs in Japanese manufacturing, which rose by 3½ per cent (on revised figures) over the year to 1986Q3, declined slightly over the year to 1987Q1. The reason is partly that the rise in average hourly earnings slowed down, but chiefly that the rise in productivity speeded up (table 1).

Table 1: Decomposition of the change in unit labour costs

	Percentage changes on a year before	
	1986Q3	1987Q1
Hourly compensation	4.1	2.8
minus		
Output per hour	0.7	3.0
equals		
Unit labour costs	3.4	-0.2

2. The rise in productivity speeded up partly because output, which had previously been declining, recovered slightly and partly because employment, which had previously been about constant, fell (table 2).

Table 2: Decomposition of the change in output per hour*

	Percentage change on a year before	
	1986Q3	1987Q1
Output	-0.8	0.4
minus Employment	0.3	-1.2
and Average hours	-1.6	-1.2
equals Output per hour	0.7	3.0

* Components do not sum exactly to output per hour because of the usual approximation involved in adding percentage changes.

3. You also asked about international comparisons of productivity in manufacturing. Such comparisons are usually only made for growth rates (as in Table 1.6 of Section X of the TWEB). Comparisons of absolute levels are fraught with difficulties. They are not attempted in any of the standard statistical publications of the OECD, IMF, UN etc.

4. There have been academic studies of the UK's comparative productivity. The results of work at the NIESR is summarised in table 3.

Table 3: Output per employee in manufacturing, 1980 UK = 100

Britain	100
Germany	152-163
US	276-302
France	180
Belgium	180
Netherlands	230
Italy	150
Japan	200

Source: National Institute Economic Review, August 1982, p.11.

5. Even if these comparisons were brought forward to take into account the UK's relatively high growth rate since 1980, the level of output per employee in UK manufacturing would still appear relatively low.

JS.

D SAVAGE

psl/2A

pugs

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

1 October 1987

Frank Judd Esq
Oxfam
274 Banbury Road
OXFORD

Dear Mr Judd,

UN NGO WORKSHOP ON DEBT ADJUSTMENTS AND THE NEEDS OF THE POOR

The Chancellor was grateful for your telex to him in Washington reporting on the outcome of this Workshop. He was very pleased to see that participants at the Workshop gave strong support for his Sub-Saharan African debt initiative.

Yours sincerely

Alex Allan

A C S ALLAN
Principal Private Secretary

1236/54

RP

FROM: MARK CALL
DATE: 2 OCTOBER 1987

PAYMASTER GENERAL

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Colenutt
Mr D Savage
Mr Cropper
Mr Tyrie

MANUFACTURING INDUSTRY

Mr Savage's minute of 1 October helpfully lays out the causes of change in Japanese unit labour costs. I hope these answer the queries you had in this regard.

2. I find it surprising that few comparisons have been made by either academics, the OECD, the IMF or the UN on absolute manufacturing productivity. The NIESR figures in paragraph 4 make rather gloomy reading. While the discrepancy between the UK level and that in Germany, the US, and Japan may be partly explained by a higher investment in automation, I wonder if that's the case in Belgium, France, Italy and the Netherlands?

MC

MARK CALL

005/2761

CHIEF SECRETARY TO THE TREASURY

RD

FROM: M C FELSTEAD

DATE: 5 October 1987

MR CALL

cc:
2 PS/Chancellor
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Miss O'Mara
Mr Cropper
Mr Tyrie

MANUFACTURING INDUSTRY

The Chief Secretary was grateful for your note on manufacturing statistics, attached to your minute of 1 October.

M C Felstead

M C FELSTEAD
Assistant Private Secretary

pwp

PAYMASTER GENERAL

FROM: S P JUDGE
DATE: 5 October 1987

MR CALL

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Colenutt
Mr D Savage
Mr Cropper
Mr Tyrie

MANUFACTURING INDUSTRY

The Paymaster General was grateful for your submission of 2 October.

The Paymaster wonders whether we could update the 1982 NIESR data (for 1980) to 1987, using productivity grwoth since then - or is he being obtuse? The Paymaster appreciates the imperfections, and notes Mr Savage's cautionary words, but thinks that if we have to be gloomy, we may as well be gloomy with an approximate 1987 picture.

S P JUDGE
Private Secretary

CONFIDENTIAL

FROM: J P MCINTYRE
DATE: 6 October 1987

CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr F E R Butler
Mr Anson
Mr Turnbull
Miss Peirson
Mr Potter
Mr Gibson
Mr Tyrie

I strongly agree that we must insist on the ~~[illegible]~~ [illegible] for single people reductions for the latter years. The balance of gainers + losers will still be better than was originally envisaged – and the current problem with the comm. charge does not lie with the single a-RA's [illegible] anyway. [illegible] M.

RATES AND COMMUNITY CHARGE: INCOME SUPPORT

As you know, the Cabinet Office are preparing a paper for next Monday's meeting of E(LF) to discuss the DOE argument that decisions on rates compensation for next year should also embrace later years, to take account of the introduction of the community charge. To this end, DOE, DHSS, and ourselves are preparing short papers setting out our respective positions. I attach a draft of the Treasury paper (and also of the papers by DOE and DHSS).

MCINTYRE TO CST 6/10

2. On procedure, we had expected that there would be a single Cabinet Office paper, cleared by interested departments, which would form the basis for the E(LF) discussions. Cabinet Office are now more inclined to write a short covering note, attaching the three Departmental papers. I have warned them that this could result in the discussion widening beyond what needs to be decided for the coming year; we need to see Mr Moore's paper on options for the community charge compensation before that can be properly addressed. In any event, I have told the Cabinet Office that you will wish to see their covering paper before it goes out.

I spoke to them. Since this sounded v unsatisfactory, & it turned out they are preparing something more substantial.
Good.

3. I had hoped that we would be able to avoid any discussion of the increase in Housing Benefit taper at Monday's meeting. But it appears that DOE are determined to raise it. This too will need to be covered in the Cabinet Office paper, and I will let you have a separate note on this tomorrow.

4. I would be grateful to know whether you are content with the attached note as a statement of the Treasury's position.

JPM

J P MCINTYRE

RATES AND THE COMMUNITY CHARGE: INCOME SUPPORT

Note by the Treasury

Ministers agreed at E(LF)87 10th meeting on 13 May that, when income related benefits were introduced in April 1988, they should be increased to put all recipients who faced the new 20 per cent minimum contribution to domestic rates in a position to meet the government's best estimate of their average liability in 1988-89. The Secretary of State for Social Services, in his letter of 28 September to the Chief Secretary, said that this compensation would amount to £1.30 a week for couples, lone parents and single people over 25; single people aged 18-24 (other than lone parents) would receive £1.

2. E(LF)87 10th meeting also agreed that it would be necessary to consider how the addition to benefits should be rolled forward after 1988-89 and that the room for manoeuvre on that should be left open. The Prime Minister told the House on 2 July that

> "For the less well off, there will be an up to 80 per cent rebate of the community charge. For the worst off who are on supplementary benefit and income support, there will be an amount added to that income support or supplementary benefit equal to the average of the 20 per cent they would have to pay."

The Secretary of State for Social Services has said he intends to circulate proposals to E(LF) shortly.

3. The link between 1988-89 and later years is a complex one. The need for compensation in 1988-89 will be exclusively for <u>households</u> paying rates (though, in practice, because the new rules governing income-related benefits from April 1988 do not distinguish between householders and non-householders, compensation will actually be paid to around half of non-householders as well). From 1989-90, the need for compensation

will increasingly be for individuals paying the community charge (and in England, for a four year period, a blend of rates and community charge). Since the average community charge will be lower than the average rate would have been, the compensation required for single householders should fall and for couples should rise.

4. The central questions for decision now are:

   a. Does the decision taken on compensation in 1988-89 narrow the options which Ministers will be able to consider for later years?

   b. If so, how can the 1988-89 decision be changed?

5. The answer to the first question is positive only if Ministers believe they could not contemplate reducing compensation for single people in subsequent years. A reduction would accord with the Prime Minister's statement that the compensation would be equal to the average of the 20 per cent they would have to pay, and would be necessary to avoid windfall gains for single people.

6. The second question does not arise if Ministers are prepared to consider reductions in compensation for single people in later years. In any event, it is difficult to see how the 1988-89 decision could be changed to avoid a future cut. A reduction in compensation for single people in 1988-89 could be seen as in conflict with the commitment to compensate for the average 20 per cent rates contributions.

7. The Secretary of State for the Environment has argued, in his letter of 2 October, that any decision to reduce compensation, as the community charge is introduced, would adversely affect the balance of gainers and losers among the poorest households from the introduction of community charge. However, the gainers and losers profile for the community charge was constructed before E(LF)'s decision to compensate income support recipients. Thus, even if that compensation is reduced for single people (because the average community charge payment will be less than their

— and, in the overwhelming majority of cases, better off than before rates were abolished.

average rates bill), they will still be better off than was envisaged when the gainers and losers profile was published.

8. There are, in any case, only two ways of avoiding a reduction in compensation for single people in later years: <u>under-compensating</u> them in 1988-89 (which would conflict with the commitment on rates) and <u>over-compensating</u> them in later years.

<u>Conclusions</u>

9. The decision on compensation for rates in 1988-89 should stand, and consideration of the position for later years should await a further paper from the Secretary of State for Social Services. Pending more detailed decisions on compensation in 1989-90 and later years, government spokesmen can rest on the pledge given by the Prime Minister quoted in paragraph 2 above.

UPRATING INCOME SUPPORT - THE COMMUNITY CHARGE

1. Why are DOE concerned?

- The 1988 uprating is special because it includes compensation for the new 20% contribution to rates. But everyone knows that domestic rates are disappearing - starting in Scotland in 1989. It has always been recognised that the system would have to reflect the introduction of the community charge.

- Because the introduction of the community charge is imminent, DOE have always argued that decisions for 1988 should not be taken in isolation - hence the Secretary of State for the Environment's letter of 30 July and subsequent official-level discussions and correspondence.

- The 'gainers and losers' figures - that 83% of single pensioner households and 85% of single parents will be better off after rates are abolished - are crucial to the Government's arguments that the community charge will be fairer than rates. These figures assume no uprating to compensate for the 20% contribution to rates. They have frequently been quoted publicly - for example at ~~the~~ PMQs Prime Minister's Questions on 30 June. It will not be possible to ??
maintain them if the uprating is reduced as the community charge is introduced. If recipients subsequently lose income, the analysis will no longer hold true.

2. Why decide (and announce) later years now?

- We will not get away with even a low-key announcement for 1988 only. There has already been speculation in the press that the 1988 uprating will not be maintained. Inability to say anything further about later years will feed critcism, especially of inadequate planning. The question of the impact of the community charge on poorer households is one of the most vulnerable areas of the policy . Ministers will be exposed on another flank during debates on the Bill if we don't have a clear line.

3. What are the options?

- If the DHSS proposal (£1 for singles under 25, and £1.30 for everyone else) is accepted Treasury may look for a clawback in 1989 because £1.30 over compensates singles. (The uprating for couples would need to go up to £1.70).

- Reducing compensation for singles over 25 in 1989 (probably to £1.10) hits our main groups of gainers - single pensioners, single pensioner households and lone parents. We would gain maximum opprobrium for the minimal benefit of giving these people 20p in 1988. Any further reductions thereafter (towards 85p) wuld make the situation even worse.

- Our alternative is for a lower start figure for singles which can be maintained in later years - ie £1.10 in 1988. The amount of uprating for couples would still need to be increased in later years.

- Although this provides less than full compensation for rates in 1988 it can be defended as part of a package - ie less than full compensation in 1988 but with the quid pro quo of not reducing in later years - and indeed providing slight over compensation.

Doc888

SECRET

ANNEX

NOTE PREPARED BY THE DEPARTMENT OF HEALTH AND SOCIAL SECURITY

WHY DHSS PES DECISIONS DO NOT PRE-EMPT DECISIONS ON THE COMMUNITY CHARGE

Introduction

1. This Annex explains why decisions setting the April 1988 benefit rates do not pre-empt decisions about compensation for the minimum 20 per cent contribution to the community charge, why it is essential to publish the proposed housing benefit rates on 12 October and why that will not pre-empt decisions relating to the community charge. The Appendix reproduces the main public pledges to include in the income-related benefit rates the average amount which income support claimants are expected to meet as their minimum contribution to domestic rates and, in due course, to the community charge.

COMPENSATION FOR THE MINIMUM 20 PER CENT CONTRIBUTION TO THE COMMUNITY CHARGE

2. It has been agreed in the PES bilaterals that the income support rates from next April should be set by uprating the December 1985 Technical Annex illustrative figures by the movement in the RPI less housing from then to September 1987. In addition, the rates are to be further increased by:

2.1 £1.30 a week for couples, lone parents and all other claimants aged 25 and over, ie the estimated overall average minimum contribution to domestic rates which income support claimants will be expected to meet next April;

2.2 £1 a week for all single claimants aged 18-24 (most claimants in this age group are non-householders with no rates liability; the average minimum contribution for those who are householders is estimated to be £1.07 next April).

It has also been agreed that the rates of the income-related benefits (income support, housing benefit and family credit) should be reduced by 50p a week (single claimants) and £1.00 a week (couples) in order to constrain the growth in social security expenditure.

3. The compensation of £1.30/£1.00 a week will discharge the Government's commitment to include the average minimum contribution to domestic rates from April 1989, although the value to claimants will effectively be diminished by the general reductions in the benefit rates of 50p and £1.

NO.

4. This level of compensation will provide the baseline on which compensation for the community charge can be determined. The estimated average minimum contribution to the community charge on a GB basis is expected to be 85p (singles) and £1.70 (couples) when fully phased in in 1994-95. In 1990-91, when phasing-in begins in England, the combined average minimum contribution for a ratepayer/chargepayer will be £1.06 (singles) and £1.44 (couples). At that time, minimum contributions of 90p/£1.80 will apply in Scotland and

LG looking at this.

52p/£1.05 in Wales. Against these average burdens, it is clear that the domestic rates compensation will be more than enough to compensate single people if carried forward, but 40p a week too low for couples, using the GB average.

5. Several courses remain open, notwithstanding the PES decisions, for compensation for the charge. It is open to the Government to decide to:

Let's not get into this next Monday

5.1 increase the amount for couples in Scotland only in April 1989 by 40p (to £1.70) at a cost of £6m. This would be the minimum increase to meet the pledge. It would be defensible at the same time to bring down the amount for singles in Scotland from £1/£1.30 to 90p, thus reducing the overall cost. This is not a solution DHSS Ministers could support, however, since it would move away from national benefit rates with serious policy and financial implications.

5.2 increase the amount for all couples in GB in April 1989 by 40p in order to meet the pledge for couples in Scotland. This would cost an extra £40m. The continuing cost of compensation would run at £439m a year compared with £399m in 1988-89. The pledges would be fully discharged, although at £1/£1.30 single people would be overcompensated by up to 45p a week by 1994-95 when the charge was fully phased-in.

5.3 increase the amount for all couples in GB in April 1989 by 40p as in para 5.2, but progressively reduce the compensation for single people from £1/£1.30 to 85p as the charge phases in. This would be defensible since the average charge and minimum contribution would be lower for domestic rates and it would be entirely consistent with the pledges. It would also bring down the continuing cost to £354m by 1994-95.

5.4 set the level of compensation in April 1989 for single people at £1.10/£1.00 instead of £1.30/£1.00 and for couples at £1.70. This would contain spending to about the same level as 1988-89 (+£5m), would overcompensate couples and undercompensate single people in E & W and would not meet the pledge on domestic rates (since the average minimum contribution would be £1.30). It would, however, meet the pledge from April 1989 in Scotland on the community charge and from April 1990 in E & W.

6. Decisions on which course to follow will depend on the view taken of the expenditure constraints, on whether offsetting savings should be found to meet inevitably higher spending initially if the pledges are to be delivered and reductions avoided, on whether reductions in the amount of compensation are acceptable, and on whether national social security benefit rates should be maintained, for wider reasons, during the changeover period. These are decisions which can be taken in E(LF) in time for mid-November when the community charge bill is to be introduced and when it would be possible to say clearly what the compensation arrangements will be.

Publication of the housing benefit rates on 12 October

7. The alignment of the income-related benefits means that the main housing benefit rates will be the same as the income support rates and they will reflect the PES decisions relating to the uprating, the £1.30/£1.00 amounts of compensation and the 50p/£1.00 reductions.

8. There is a statutory requirement to consult the local authority associations (LAAs) about the housing benefit regulations and the rates before they are laid before Parliament. It is also essential for all the regulations to be made by 23 November to enable the reassessment of some 6 million cases in DHSS local offices and 7 million cases in local authorities to proceed. Delay will mean that the new schemes will not be introduced as planned in April 1988.

9. Working back from 23 November, the regulations must be debated in both Houses (affirmative procedure), they must go through the JCSI (for which two sittings may be necessary because of the length and complexity of the six sets of main and transitional regulations), and the consultation process with the LAAs must be concluded.

10. Treasury Counsel's strong advice is that in order to reduce the risk of successful challenge to the housing benefit provisions by judicial review, it is essential that the LAAs are given at least 2 weeks to comment and that the Secretary of State has 1 week to consider the comments before laying the regulations. on this basis, the proposed timetable (subject to the Business Managers) is:

12 October - housing benefit rates notified to the LAAs for comment

26 October - last date for comments

26 or 27 October - Social security uprating announcement

27 - 30 October - Secrtary of State to consider comments and his response

2 to 5 November - draft regulations containing final rates laid before Parliament

10 and, possibly 17 November - JCSI consideration (two sittings possible)

18/19 November - debates on the general uprating and the income-related benefit regulations

23 November - action date for operations

10. Failure to meet the first date - 12 October (13 at the latest)-will make the timetable unattainable unless less than 2 weeks is allowed for the consultation exercise. That would provoke the LAAs and in the event of legal challenge seriously weaken the Secretary of State's position. The end date of 23 November cannot be extended if the new schemes are to start on time; it has already been squeezed back to the last possible moment.

Pledges

11. The attached Appendix records the three main pledges known by DHSS to be on the record:

A: Mr Fowler (then Secretary of State for Social Services) on compensation for domestic rates - 15 May 1987

B: Mr Ridley - community charge - 1 July 1987

C: Prime Minister - community charge - 2 July 19 7.

APPENDIX

MAIN PLEDGES ON COMPENSATION FOR THE MINIMUM 20 PER CENT CONTRIBUTION TO DOMESTIC RATES AND THE COMMUNITY CHARGE

A: Mr Fowler (then Secretary of State for Social Services)
Written Parliamentary Answer and DHSS Press Notice on 15 May 1987.

"The draft regulations confirm that from April 1988 the Government expects everyone who is liable to pay domestic rates to make a minimum contribution of 20 per cent of their rates bill. However, when the rates for income support are set in the autumn, they will include the average amount that we expect householders who are income support claimants to have to meet as their minimum contribution. The details will be determined at the time the benefit rates are decided. This will mean that income support claimants will receive compensation in April 1988 in their benefit entitlement, whilst at the same time preserving the vital principle of local accountability. This compensation will also be reflected in the rates that will determine help for others on low income receiving housing benefit and family credit."

B: Mr Ridley, House of Commons, 1 July 1987 (Debate on the Address)

Mr Ridley: The Hon. Gentleman has asked about the 20 per cent paid by the poorest. The Government have made it absolutely clear that up to 80 per cent rebates will be available for those on low incomes. With regard to the 20 per cent, income support will be uprated by the equivalent of the average of the 20 per cent of the community charge. We have always stated that. That means that some people on income support will be slightly better off, although some may be slightly worse off.

C: Prime Minister, House of Commons, 2 July 1987 (PM's Questions)

For the less well off there will be up to an 80 per cent rebate of the community charge. For the worst off who are on supplementary benefit and income support, there will be an amount added to that income support or supplementary benefit equal to the average of the 20 per cent that they would have to pay. So they will not be adversely affected.

A8/15

SECRET

bf for meeting

83/8

COLMAN TO CH/EX 8/10

FROM: J G COLMAN
DATE: 8 October 1987

1. MR D J L MOORE note attend DJLM 9/10.
2. CHANCELLOR

cc Financial Secretary
Sir P Middleton
Mr Monck

BRITISH STEEL CORPORATION

Mr Kenneth Clarke's minute of 2 October to the Prime Minister reports the latest position on the future of the BSC in preparation for a further discussion on 27 October by the same group of Ministers who met in July. This submission discusses the paper and is also a brief for your meeting with Mr Clarke on 13 October.

2. Because of the startling improvement in BSC's profits and perceived prospects since then, the proposals presented now differ markedly from those discussed then. The new proposals are summarised in paragraph 3 of Mr Clarke's minute. A key point is that it is no longer thought necessary that a definite decision to close Ravenscraig must be taken before BSC can be privatised. And, what is more, BSC have reached that conclusion on purely commercial grounds.

3. Mr Clarke has requested the bilateral meeting with you on his own initiative. We think that he wishes to ensure that you and he are at one before the 27 October meeting. Despite the good news on BSC's performance there are still some problem areas, however, as described below.

Ravenscraig's eventual closure

4. Ravenscraig's long term prospects are unaltered: BSC will want to close it eventually; all that is in doubt is for how many more years steel making will be needed there. The closure of the hot strip mill (HSM), and the investment in continuous

casting plant (concast) in South Wales will signal BSC's intention to close Ravenscraig in due course, even if BSC give commitments about not doing so for 5 years, say. Even in the short term, therefore, closure of the hot strip mill at Ravenscraig is likely to be opposed with much the same vigour that outright closure would have been; even though only 400 rather than 3100 jobs could be at stake.

New Plate mill not to be in Scotland

5. The proposed new plate mill offers no help to Ravenscraig. BSC want to defer their decision on whether to build it and where to site it until after privatisation, but what Mr Clarke does not mention is that they are very clear that it cannot sensibly be Scotland. BSC's argument is that a new plate mill, once the economic case for it has been made, will be a 30-year investment. It is therefore essential that it should be put on a site where BSC are confident steel making has a long term future. Since they see BSC as possibly ending up as a two-site operation: Port Talbot (with back-up from Llanwern) and either Scunthorpe or Teeside, the plate mill should go either to South Wales or the North East. BSC are saying that they would want it made clear before privatisation that the plate would not go to Scotland. We are not sure about the logic of this, given that the line being proposed by them and DTI is that decisions on the plate mill are for BSC alone after privatisation. It can only add to the political problem in Scotland for HMG to go out of their way to dash any hopes there might be of siting the plate mill there. Nevertheless, it is true that such hopes are misplaced. Therefore it would be dangerous to let Mr. Rifkind or the Scottish public think that there is any reasonable chance of a plate mill in Scotland. It would be worth your discussing the tactics with Mr Clarke. [initials]

Surely not in those terms!

Seamless Tubes

6. The seamless tubes business is in trouble. Mr Clarke merely refers to "further consideration", but it seems certain that the Clydesdale mill (with some 1700 jobs) cannot survive as a commercial operation. There has been talk (which we have discouraged) of "Government money" being put into it. This

proposal is seen as a major gesture to help deal with the Scottish problem. The cost rises every time we hear of it: currently the idea is that £75m new investment would be made at Clydesdale, the Wednesfield works would be closed as part of a deal with the French (whose seamless tubes business is also in trouble) and the Bromfield works would survive. It is said that the renovated and slimmed down business would then be privatisable, but we think that it is ominous that BSC do not want to be the owners of it after BSC's own privatisation. Mr Clarke himself may not be enthusiastic about the idea of putting money into the seamless tubes business. BSC and DTI officials, however, are very keen that the option of doing so should not be ruled out without further study. It seems to us that it is very likely that such a study would show that the only justification for the idea would be political.

We cannot oppose further study. But despite the employment/political problems for Scotland you should warn against heavy investment in an unpromising venture JW.

Job creation Programme

7. The proposed programme of job creation in the Ravenscraig area needs careful handling. The idea emerged at the July meeting as a means of being seen to respond to the announcement of the total closure of Ravenscraig. The proposed closure of the HSM will give rise to only 400 job losses. Although Ravenscraig's eventual fate would be sealed, it would be several years away, so a major immediate programme with Government funding would be a disproportionate response which risks making the decision look worse for jobs than it really is. The HSM closure alone could readily be handled by BSC in their normal way, using BSC Industry. Major decisions on shipbuilding are imminent however. Mr Clarke will be proposing to E(A) later this month the rapid closure of British Shipbuilders' remaining yards, including the Govan yard with 1800 jobs just a few miles from Clydesdale, and 30 miles from Ravenscraig. The privatised warship yard Yarrow is also expected to have to reduce its workforce by one half. Thought needs to be given to the timing and presentation of any announcement of decisions on steel and shipbuilding. Any special employment measures adopted to help with the Govan closure would also help ex-steel workers

and one option would be to rely on these, partly to avoid foreshadowing the closure of steel-making at Ravenscraig. Another would be to extend the scope of the shipbuilding measures, to cover the HSM as well, if it is thought necessary for there to be specific Government action on that front at all. We gather that Mr Clarke will not be making any proposals for a job creation programme. He has not referred the BSC case to the official group on special employment measures, as he has done the British Shipbuilders case. But his officials certainly, and probably Mr Clarke, do see the programme as an important element in dealing with the Scottish political problem. We need to know the specific public expenditure commitments proposed before agreeing to anything here. DTI point out that the 8 July meeting at No 10 encouraged ideas of a "well funded enterprise company" + so think there is some commitment to additional expenditure. AWR.

Competition in Steel

8. No-one is advocating breaking BSC up for privatisation (BSC faces international competition, and a break-up could not be done in time for a sale at the end of 1988). The steel market is far from perfectly competitive, however: not only does the EC external regime keep EC steel prices above world market levels, but within the EC barriers there are two cartels (a European cartel run by Eurofer, and a cartel of producers of stainless steel) which distort the market further. Given that BSC is far larger than all the EC producers except the French national one and that BSC when privatised intend to tighten their grip on the market by purchasing UK stockholders, you could ask Mr Clarke whether, on competition grounds and to avoid damaging the European engineering industry's competitiveness, there is a case for some action against the cartels before a sale; and propose that DTI officials should produce a paper on this, preferably consulting the Treasury. DTI officials dealing with BSC will no doubt argue that such action could be damaging to the chances of a quick privatisation. But I agree the question must be examined.

Agree

The need for legislation

9. The lawyers are adamant that fresh primary legislation will be needed if BSC is to be privatised as a single entity. No place exists in the legislative programme for this Session for such a bill. It would be of medium length, and not

technically difficult, but it would be higly controversial. It would need to be introduced no later than Easter 1988, for Royal Assent to be obtained in good time for a sale in November 1988, no later than say July 1988, say, and preferably earlier. You could ask Mr Clarke whether he has made any progress in getting an early slot for DTI legislation.

Combine Steel with RDG Bill

(Mr Monck tells me that Lord Young has secured with Lord Whitelaw some time for RDGs)

Timing of the sale

10. Both BZW and Samuel Montagu are sure that BSC cannot be ready for sale before the Autumn of 1988. To be clear of both the Autumn Statement and the Budget, the only possible time in 1988-89 is November-December 1988. If that is missed the next slot would be after publication of BSC's results for 1987-88 in July 1989. BSC and the advisers would have liked January 1989 but I said that was too close to your 1989 Budget with consequent risks of disclosure problems.

??

Line to take

11. Mr Clarke is likely to concentrate on the political aspects, and especially the handling of the Scottish dimension. On specific points we recommend you take the following line:

a. favour early privatisation of BSC on basis proposed;

b. accept new plate mill not available to comfort Scotland, but question need to go out of way to make this clear before privatisation;

c. discourage (but not to extent of ruling out options) expensive measures to prop up seamless tubes business;

d. stress need for decisions on job creation programme to take full account of whole picture on jobs in Scotland including, especially shipbuilding; and need to look at the public expenditure implications.

e. propose that DTI should produce a paper on competition aspects (paragraph 8)

No

f. ask about progress in finding a slot for legislation.

J.G.C.

J G COLMAN

With you.

My note to you of 8 October on privatisation proceeds 1988-89 to 1991-92 is relevant to this. The conclusion is that a 1988 BSC privatisation is good news in its own right and in terms of managing the overall programme: BT no longer looks a sensible starter for 1988 and so it is extremely welcome to have BSC coming forward. We will aim to do BT in 1989 and we very much hope that BSC would not slip back to 1989, though we would make room for it in Summer 1989 if we had to.

D J L Moore

PRODROME B WSH

83610 OXFAM G
TLX NO 7025 87-09-25 15:40

TO: NIGEL LAWSON, BRITISH EMBASSY, WASHINGTON
TIM LANKESTER, UK EXECUTIVE DIRECTOR TO THE IMF AND WORLD BANK

UN NGO WORKSHOP ON DEBT ADJUSTMENT AND THE NEEDS OF THE POOR

19TH-22ND SEPTEMBER 1987

A.

OXFAM HAS CO-SPONSORED THIS IMPORTANT AND SUCCESSFUL WORKSHOP. PARTICIPANTS CONCLUDED BY DRAWING UP A STATEMENT OF ANALYSIS AND ACTION. WE WILL SEND THE FULL STATEMENT TO YOU SHORTLY BUT FOR THE PRESENT I WANT TO DRAW YOUR ATTENTION TO SOME OF THE KEY POINTS ARISING FROM THE WORKSHOP (AS FOLLOWS) WHICH I HOPE YOU CAN BEAR IN MIND AT THIS WEEK'S MEETING.

B.

PARTICIPANTS AT THIS WORKSHOP GAVE STRONG SUPPORT FOR THE ''LAWSON PLAN'' TO EASE AFRICAN DEBT BURDEN AND WISH YOU ALL SUCCESS IN SECURING ITS ADOPTION AT THE FUND/BANK MEETINGS.

C.

PARTICIPANTS AT THE WORKSHOP CALLED FOR FURTHER NORTHERN ACTION TO THE DEBT BURDEN.

D.

PROPOSALS, BASED ON EXTENSIVE NGO EXPERIENCE OF THE HUMAN AND ENVIRONMENTAL CONSEQUENCES OF THE DEBT CRISIS INCLUDE:-

1. NEW BANK/FUND OPERATIONAL POLICIES ENSURING FULLER AND MORE MEANINGFUL DIALOGUE WITH GRASS ROOT NGOS ON ADJUSTMENT PROGRAMMES.
2. MORE SYSTEMATIC MONITORING OF IMPACT OF ADJUSTMENT PROGRAMMES ON THE POOR.
3. MORE EMPHASIS WITHIN ADJUSTMENT PROGRAMMES ON SELF-RELIANCE RATHER THAN EXPORT-LED STRATEGIES, ESPECIALLY IN FOOD SECTOR, AND ON INCREASING ACCESS OF POORE TO LAND AND OTHER PRODUCTIVE ASSETS.
4. EXTENDING THE ''LAWSON PLAN'' TO ALL IDA-ELIGIBLE COUNTRIES.
5. NORTHERN GOVERNMENT SHOULD ENSURE THAT TAX RELIEF ON COMMERCIAL BANK' LOAN LOSS PROVISIONS CONTRIBUTES TO EASING THE BURDEN OF DEVELOPING COUNTRIES' DEBT.
6. A SPECIAL INTERNATIONAL TRIBUNAL SHOULD BE ESTABLISHED TO CONSIDER QUESTIONS TO SELECTIVE REPUDIATION OF PARTICULARLY INAPPROPRIATE COMMERCIAL BANK LOANS.

Story Ended

E.

THE OXFORD WORKSHOP WAS JOINTLY ORGANISED BY OXFAM, QUEEN ELIZABETH HOUSE AND THE UN NON GOVERNMENTAL LIAISON SERVICE AND INCLUDED NGOS FROM AFRICA, ASIA, LATIN AMERICA, THE CARIBBEAN, US, JAPAN, AUSTRALIA AND EUROPE AND STAFF FROM UNICEF, UNDP, ILO, WORLD FOOD PROGRAMME AND WORLD BANK.

FRANK JUDD, OXFAM

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