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PART A

CHANCELLOR'S APPEARANCE BEFORE THE HOUSE OF LORDS (HOL) COMMITTEE ON OVERSEAS TRADE, 15 MAY 1985

PO -CH /NL/0122
PART A

Begins: 1/5/85
Ends: 13/5/85

DD: 25 years

5/9/95

5/1246

RESTRICTED

FROM: P N SEDGWICK
DATE: MAY 1 1985

? [illegible] ([illegible])?

for meeting folder (13/5)

CHANCELLOR

Yes! Membership of CAB & their business authority.

cc Chief Secretary
Economic Secretay
Sir P Middleton
Sir T Burns
Mr Littler
Mr Monck
Mr Unwin
Mr Battishill
Mr Fitchew
Mr Lavelle
Mr Mountfield
Mr Beastall
Mrs Case
Mr Culpin
Mr Kelly
Mr Mowl
Mr Aaronson
Mr Courtney
Miss Henderson
Mr Pratt
Mr Cropper
Mr Anson

HOUSE OF LORDS COMMITTEE ON OVERSEAS TRADE

Mr Unwin's note to you of April 2 summarised the arrangements that we have set in hand to prepare for your appearance before the House of Lords Committee on Wednesday May 15. A full set of briefs will come forward, as promised in Mr Unwin's note, by the end of this week. This note takes stock of developments in recent weeks and presents some of the material we have prepared for you.

Publicity

2. At the moment you are the only Minister who will definitely appear before the Committee. The Committee has invited Mr Tebbit to appear, but as far as we are aware he has not yet responded.

3. You will be aware of the publicity - notably in the Times and Channel 4 news - given to the views that Lord Weinstock and Mr Harvey-Jones expressed before the Committee. The Prime Minister commented on these views at question time the next day. (I attach at Annex A the Hansard report on her remarks.)

4. It is likely that your appearance will provoke at least as much publicity, and the proceedings could well be televised and featured on news programmes.

Notes requested by the Committee

5. The Committee has asked the Treasury for information on

(i) the aims and principles of public purchasing policy (with special reference to the profitability of defence contractors and the suppliers of pharmaceutical products), together with an assessment of the impact of public purchasing policy on the balance of trade,

and (ii) estimates of future production and the likely balance of trade in oil in future years.

In addition the Commitee Chairman, Lord Aldington, wrote to the UK's Ambassador in Washington and asked for information on

(iii) US experience and the lessons to be learned by the UK from it.

6. Mr Jones of TOA circulated a draft note on public purchasing for the Committee under cover of a minute to the Chief Secretary of April 25.

7. A draft note by EA2 on oil production is attached at Annex B. This presents information on oil production that is already published (by the Department of Energy and in the

Treasury press note on oil revenues published on budget day), but in addition emphasises - as you did in your Cambridge speech - both that the run down in production is likely to be a gradual and lengthy process, and that there is a possibility that estimates of reserves, and therefore future production, could be increased. For obvious reasons that the note sets out it does not include forecasts for the balance of trade in oil other than the figure for 1985 given in the FSBR. There is, however, a useful forecast of continued self-sufficiency in oil until 2000 by UKOOA to which the note refers.

8. The notes on public purchasing and oil production ought to reach the Committee before your appearance. We suggest sending them at the end of next week and should be grateful for clearance to do so.

9. The request for information from the Washington embassy is rather more unusual. No-one can recall such a request going direct to an ambassador, rather than being routed through the FCO. In order to avoid setting an unwelcome precedent we have asked that the note should go to the Committee under a covering letter from the FCO. At the moment it seems likely that this will reach the Committee after your appearance.

Briefing for your appearance before the Committee

10. While the full set of briefs for your appearance will reach you later we thought that it might be useful for you to see some of the material at this stage to see if you are happy with the overall approach. I attach at Annex C a draft by Mr Aaronson of FEU of a short opening statement that you might make. This attempts to strike a balance between on the one hand showing concern for manufacturing industry and rebutting the charge of the Treasury's "complacency" while on the other hand stating firmly both that manufacturing output and trade are no more important than other forms of output and trade and that manufacturing has declined as a share of GDP in all developed countries over the last 15-20 years.

11. While preparing material for your appearance before the Committee we have gathered together a considerable amount of information on the performance of manufacturing industry in developed economies. There has been a tendency for members of the House of Lords Committee and many commentators to regard the performance of manufacturing in the UK, and especially in the last five years, as uniquely awful. The material we have assembled shows that manufacturing's shares in GDP and total employment have fallen significantly in nearly all industrial countries, and that far from this being a recent development it is a process that has been underway for a long time. This will provide you with some telling material to use before the Committee and we thought it would then be useful to present this material as an EPR article. I attach at Annex D a draft EPR article by Mr Courtney of FEU that has been discussed with Sir T Burns and Mr Unwin. We think that it would be useful to publish this, if you agree, in the EPR that will come out in early July. This will allow us to make any changes that seem necessary in the light of the discussion when you appear before the Committee, and the article will probably still come out before the House of Lords Committee publishes what will certainly be an unhelpful report. If on the other hand you thought it useful to publish the article in the late May EPR this would still be possible. It would not, however, be possible to alter it after your appearance before the Committee, and we therefore favour the latter date. We are, however, preparing for the May EPR a short article on recent developments in trade policy - including summaries of the Michalski and Silberston reports - which should provide useful material to counter the views of the Committee and others on protection and export subsidies.

P.N.S

P N SEDGWICK

SR

FROM: R H AARONSON

DATE: 3 May 1985

CHANCELLOR

cc: Chief Secretary
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Littler
Mr Anson
Mr Monck
Mr Unwin
Mr Battishill
Mr Fitchew
Mr Lavelle
Mr Mountfield
Mr Sedgwick
Mr Beastall
Mrs Case
Mr Culpin
Mr Folger
Mr Jones - TOA
Mr Kelly
Mr Mowl
Mr Melliss
Mr Riley
Mr Courtney
Mr Haig
Mr MacAuslan
Mr Pratt
Mr Kaufmann
Mr Cropper
Mr H Davies

HOUSE OF LORDS COMMITTEE ON OVERSEAS TRADE

As promised in Mr Sedgwick's minute of 1 May, I attach a set of briefs for your appearance before the Committee on 15 May. I am most grateful to those who have contributed.

2. An index of briefs is attached immediately behind this minute. A draft of the opening statement (Brief 1) was attached to Mr Sedgwick's minute of 1 May. Most of the other briefs listed are attached here, with the exception of those on mixed credits (Brief 8) and public purchasing (Brief 12), which have been delayed in order to take account of recent events. We will need to polish and revise some of the other briefs in the light of events next week. We are also preparing a table showing the main points raised by outside bodies who have given evidence to the Committee.

R.H. Aaronson

R H AARONSON

1/1764

HOUSE OF LORDS COMMITTEE ON OVERSEAS TRADE

LIST OF BRIEFS

1. OPENING STATEMENT

2. LONG TERM INTERNATIONAL TRENDS : share of manufacturing in GDP, import propensities, visible and invisible trade balances.

3. CHANGES IN THE STRUCTURE OF UK TRADE AND OUTPUT, including effects of North Sea developments.

4. OUTPUT AND TRADE OVER THE LAST CYCLE

5. RECENT TRADE FIGURES, including effects of coal strike

6. SHOULD WE RUN A BIGGER CURRENT ACCOUNT SURPLUS?

7. TRADE POLICY (a) General approach. Recent international meetings

   (b) Specific issues (GATT round, MFA, VRA's

8. MIXED CREDITS (a) Generall approach

   (b) Controversial cases

9. ECGD (a) Financial problems

   (b) Market limits

   (c) Controversial cases (Turkey, Oman, Nigeria)

   (d) Fixed rate finance and Byatt Report

10. EC (a) Internal market

    (b) Effect of enlargement on Spanish import restrictions

11. EXCHANGE RATE POLICY, including EMS

12. PUBLIC PURCHASING (a) Policy

(b) Profit margins for defence contractors

(c) Profit margins for NHS pharmaceutical suppliers

(d) Central Purchasing Unit

13. INDUSTRIAL SUPPORT

14. INFRASTRUCTURE

15. CORPORATION TAX

16. EDUCATION AND TRAINING

17. PERSONALITY BRIEF

ANNEX: D

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TRENDS IN MANUFACTURING TRADE AND OUTPUT

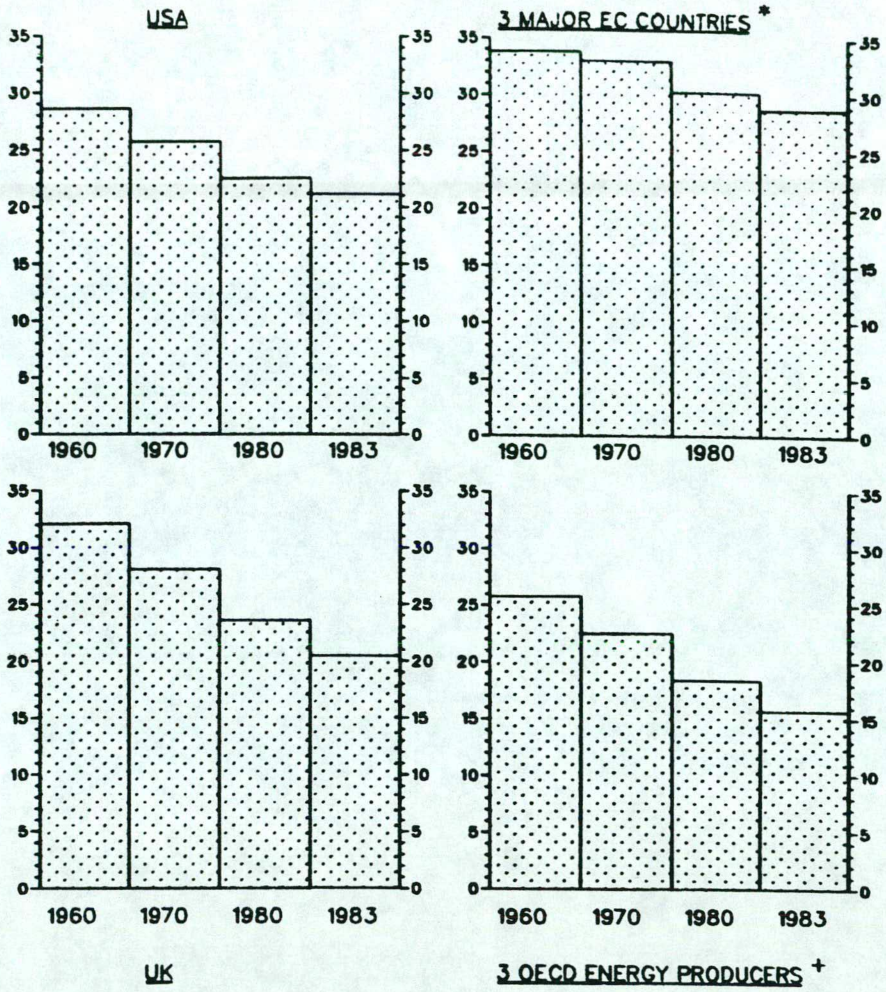
In almost all the industrial countries, the importance of manufacturing as measured by its contribution to GDP has been declining since the early 1960s. Over the last fifteen years the share of manufacturing in employment has also declined. But manufacturing has maintained its share of international trends. This article sets out the trade in manufacturing output and employment in the industrial countries, and examines the changing relative position of their trade in manufactures.

Output and Employment

2. Over the last twenty-five years the industrial economies have experienced a steady shift in the balance of economic activity from manufacturing and agriculture into the service industries. These include not just trade, transport and communication, and the traditional financial services such as insurance, banking and brokerage, but also consultancy, reseach and development, films and television, and community services such as educational, medical and recreational services. In all the seven major industrial countries there has been a decline in the proportion of the GDP which is contributed by manufacturing output, with the decrease accelerating after 1970. Only in Japan and Italy was there a slight upward trend in manufacturing's share until the decline started in the early or mid 1970's. Chart 1, based on the figures in Table 1, displays developments in four countries or groups of countries, namely the US, the UK, a weighted average of the three other major EC countries, and a weighted average of the three OECD countries other than Britain which have become net energy exporters since 1960.

CHART 1

VALUE ADDED IN MANUFACTURING AS A PERCENTAGE OF GDP



Source: Table 1
*France, Germany, Italy – weighted average
+Canada, Netherlands, Norway – weighted average

3. In Britain, the rate at which manufacturing's share has fallen has been similar to that in Canada, slightly faster than in the US and about one and a half times as fast as the fall in W.Germany or Japan. Only in Norway and the Netherlands, fellow oil producers, has the fall in manufacturing's share been faster. In Britain the share of manufacturing in output is now equal to that in the US, and below that in the other major EC countries.

4. Much of the fall in the value share of manufacturing in GDP before the early 1970's can be attributed to falling

prices for manufactures relative to services. In volume terms, manufacturing's share fell very much less. Since 1971, the shares of manufacturing in output and employment have fallen at nearly equal rates which is the counterpart to a rise in the proportion of services in the GDP, not only in value but also in volume terms. This is a development common to all the major industrial countries except Japan.*

5. Along with these production changes has gone a fall in the proportion of those employed in manufacturing industries. Although common to all major countries, this relative decline in manufacturing employment has depended on the importance of manufacturing in the economy concerned and on productivity trends in manufacturing relative to other sectors. In countries with highly productive agricultural and service sectors or significant extractive industries, manufacturing tends to figure less prominently in output than it does in employment. Examples are Canada and the UK. But in countries like Japan and Italy, where productivity is high in manufacturing relative to other sectors, manufacturing bulks larger in output than in employment.

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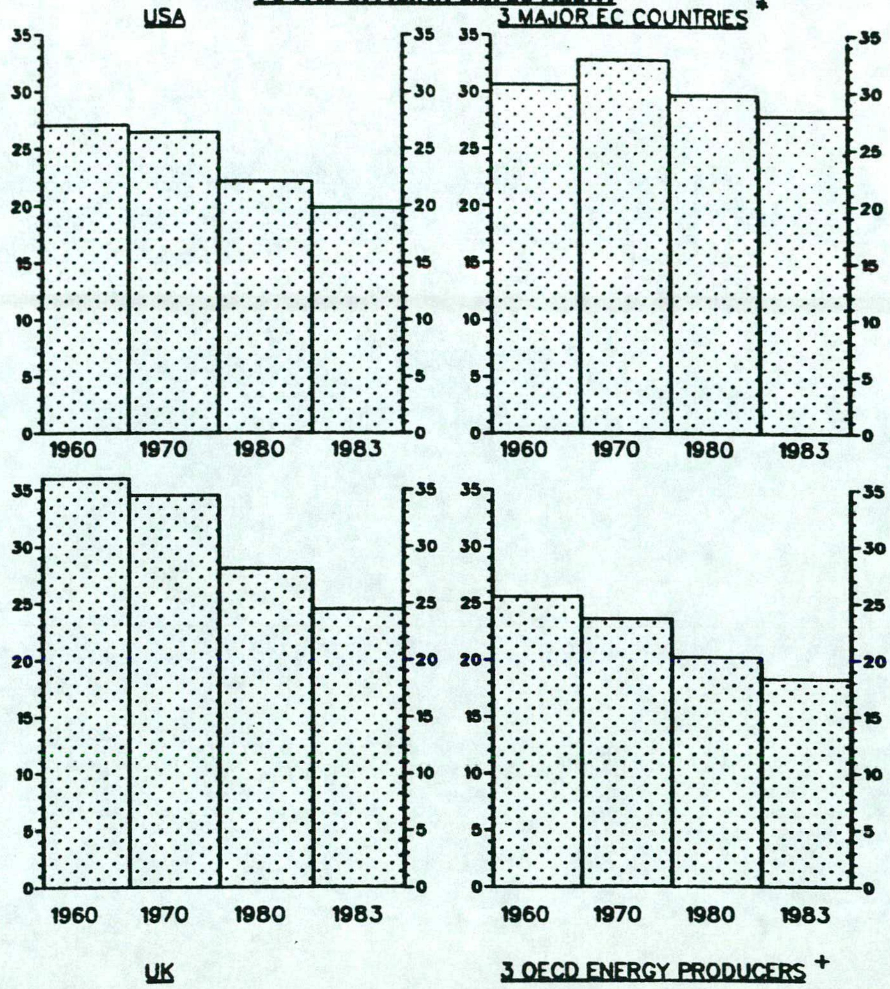
*cf. The paper by T S T Key "Services in the UK Economy", Bank of England 11 March 1985.

CHART 2

EMPLOYMENT IN MANUFACTURING AS A PERCENTAGE OF TOTAL CIVILIAN EMPLOYMENT



Source: Table 2
*France, Germany, Italy – weighted average
+Canada, Netherlands, Norway – weighted average

6. The share of manufacturing in total employment remains highest in Germany. Britain is now comparable to France, Italy and Japan and continues to have a higher share employed in manufacturing than the US.

Productivity

7. Behind the changes in output and employment have been changes in productivity in the various branches of output. Throughout the period, manufacturing productivity has tended to grow faster than productivity in output as a whole, but in both categories and for all countries there was a marked slowdown in productivity growth after

1973. The high productivity growth in manufactures before 1973 is one reason for the decline is their price relative to services over that period, though changes in tastes probably played a part as well. Except for the most recent period, productivity growth in the UK, both overall and in manufacturing, has been at similar rates to that in the US or the other OECD energy producers, but slower than in the European countries. Since 1979 productivity growth in the UK has been faster than elsewhere, showing a return to the kinds of rates experienced in the 1960s and early 1970s.

8. Table 3 (based on OECD data up to 1979, and UN and ILO figures for 1979-83) shows productivity growth for GDP as a whole and for manufacturing for the same country groupings as were used in charting the output and employment trends.

TABLE 3

Year to Year Percentage Changes in Real GDP per Person Employed

	1960-1968	1968-1973	1973-1979	1979-1983
US	2.6	1.2	0.2	0.2
3 major EC countries	5.0	4.5	2.7	1.1
UK	2.7	3.0	1.2	2.1
3 OECD energy producers	3.1	3.3*	1.1	-0.1

Year to Year Percentage Changes in Real Value Added in Manufacturing Per Person Employed

	1960-1968	1968-1973	1973-1979	1979-1983
US	3.2	3.7	0.9	2.0
3 major EC countries	6.1	5.3	3.5	1.0
UK	3.4	3.9	0.7	3.4
3 OECD energy producers	4.4	4.9*	1.7	0.6

* excludes Norway

Exports

9. Changes in the structure of output and demand have been reflected in the composition of the industrial countries' trade. In addition, there has been the liberalisation of world trade under the auspices of the GATT, particularly in the Kennedy and Tokyo rounds of tariff reductions, with their

effects spread out from 1967 onwards. This liberalisation applied chiefly to manufactures rather than to primary goods or to services.

10. In volume terms, manufactured exports from the OECD countries have grown consistently faster than their corresponding production. The same applies to OECD exports of goods and services in general, which grew slightly more slowly than manufactured exports prior to 1973 and slightly faster since.

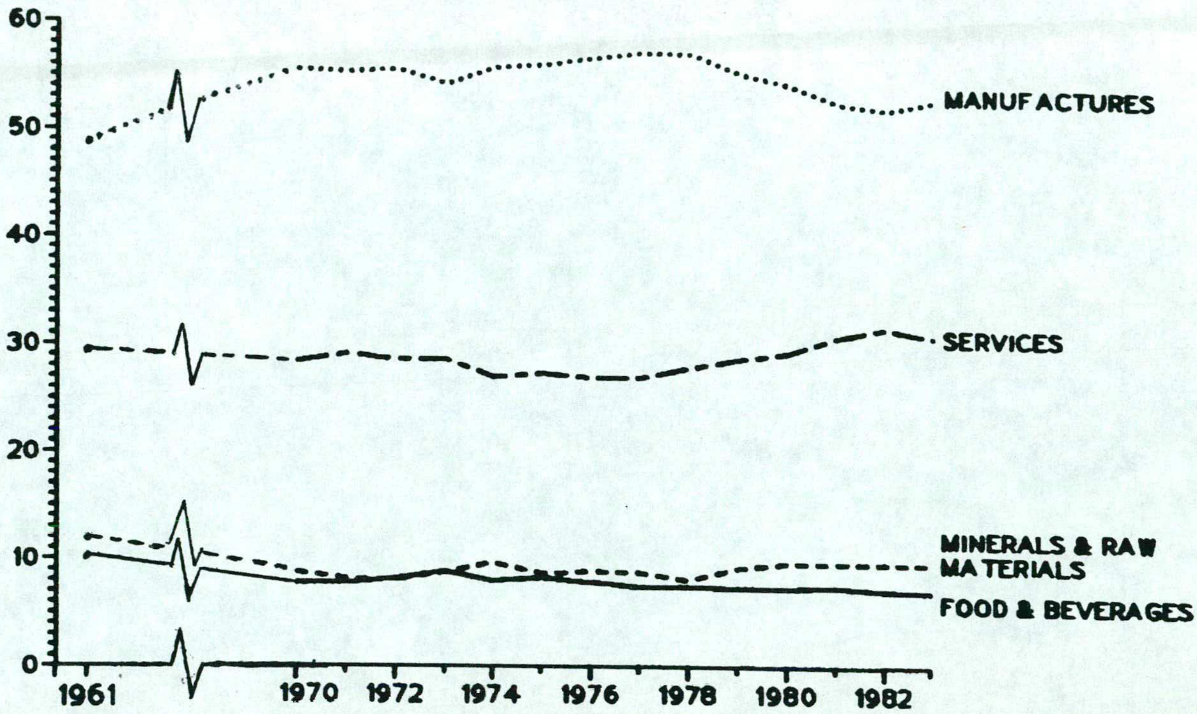
Table 4

OECD Countries Output and Exports
Year to Year Percentage Changes

	Manufactures			
	1960-68	1968-73	1973-79	1979-83
Real value added in manufacturing	6.3	6.0	2.4	0.8
Exports of Manufactures (Volume index)	7.9	9.2	5.0	2.3
			All Goods and Services	
Real GDP	5.1	4.8	2.7	1.2
Exports of goods and services (Volume index)	7.3	9.1	5.2	2.6

11. In value terms, a comparison of the value share of OECD exports confirms the increasing share of manufactures until the mid-1970's, and the slight decline in their share since then, reflecting both the faster growth of service exports and the increase in mineral (mainly oil) exports since then.

VALUE SHARES OF O.E.C.D. VISIBLE AND INVISIBLE EXPORTS



12. The shares which individual countries took of total OECD exports in the various sectors are displayed in Table 5. The most striking changes in the period from 1970 to 1983 have been the increased share of both service credits and manufactured exports taken by Japan, and the change in the export balance of the energy exporting countries.

TABLE 5

PERCENTAGE SHARES OF OECD EXPORTS

	All goods and services		Services		Food, Beverages and tobacco		Minerals and raw materials		Manufactures	
	1970	1983	1970	1983	1970	1983	1970	1983	1970	1983
Canada	6.6	5.4	4.0	2.4		7.3		13.5		4.9
US	21.5	20.3	26.9	26.1	21.8	23.4	25.8	18.8	17.8	16.1
Japan	7.5	11.2	4.6	7.4	2.8	1.2	1.5	1.1	10.9	16.6
France	8.1	9.1	7.7	11.6	11.7	12.5	5.4	4.7	8.1	8.1
Germany	14.1	12.8	10.1	9.3	4.6	7.4	7.4	6.1	18.4	17.4
Italy	6.2	5.9	6.6	5.0	4.7	4.1	3.8	2.9	6.7	7.3
Netherlands	5.0	5.1	5.1	4.7	11.8	10.8	8.3	12.2	4.1	3.8
Norway	1.6	1.6	2.7	1.7		1.0		6.5		0.8
UK	10.2	8.5	13.6	9.5	5.3	5.6	4.4	14.1	9.8	7.3

Imports

13. The counterpart to the rapid expansion of OECD countries' exports has been a faster increase in their imports than in their total domestic expenditure, in other words an increase in their import propensities. This was the case both for imports of manufactures and for overall imports of goods and services.

14. In making cross-country comparisons of import propensities, it is necessary to take into account that import propensities are in general a decreasing function of country size. Thus, the US has a much smaller import propensity than the individual European countries, but the import propensity for the EC as a whole, with intra-EC trade netted out, is not much larger than for the US.

Imports of Goods and Services
as a percentage of domestic demand (current prices)

	1960	1970	1980	1983	average annual % growth rate in average import propensity, 1970-80
Canada	18.4	21.1	27.5	23.3	2.7
US	4.4	5.5	10.9	9.3	7.1
Japan	10.4	9.7	14.7	12.3	4.2
France	13.2	15.9	23.6	23.9	4.0
Germany	16.9	19.5	27.5	28.6	3.5
Italy	14.2	17.3	27.2	25.8	4.6
Netherlands	47.2	45.8	52.7	56.9	1.4
Norway	42.3	42.6	43.9	41.3	0.3
UK	22.1	22.6	25.9	25.9	1.4
(UK excluding oil)	(20.9)	(21.6)	(24.4)	(24.4)	(1.2)
EC 10 countries, intra-trade netted out	...	9.7	13.5	13.3*	3.4

*1982.

15. In all the major countries, the trend has been for import propensities to grow over time.* Britain, which in 1960, and even in 1970, was more open than France, Germany or Italy, countries of comparable size, has experienced a much slower growth in import penetration, and is now slightly less open than a weighted average of these three countries. To some extent, the relatively slower growth in the import propensity in Britain can be attributed to decreasing oil imports after 1975 and the static volume of agricultural imports after 1958. In countries like Japan more of the rise in the import propensity since 1973 can be attributed to the rising cost of fuel imports.

16. If attention is concentrated more particularly on manufactures, there has been a similar increase in import propensities over the last decade, with the fastest rates of increase being recorded by Italy, Britain and the US, and the slowest by Canada, the Netherlands and Japan. Over the period 1970-1980 the manufacturing import penetration ratio grew faster than the penetration by total imports in the European countries except France, and more slowly than total imports in the US, Canada and Japan.

17. Overall, the manufacturing import penetration ratio in Britain remained in 1980, as in 1970, slightly below the weighted average ratio for France, Germany and Italy. Since 1980 the manufacturing import propensity has risen by almost four percentage points in the UK, and the indications are that there has been a rise in manufacturing import propensities in most of the other countries as well.

*In examining the ratio of imports to domestic demand no allowance is made for the export content of imported goods.

IMPORTS OF MANUFACTURES AS A PERCENTAGE
OF DOMESTIC DEMAND FOR MANUFACTURES (CURRENT PRICES)

	1970	1980	average annual % growth in manufacturing import propensity 1970-1980
Canada	27.0	31.1	1.4
US	5.6	9.3	5.3
Japan	4.7	5.8	2.0
France	16.2	23.3	3.7
Germany	19.3	31.4	5.0
Italy	16.2	32.0	7.0
Netherlands	51.5	61.7	1.8
UK	16.2	28.2	5.7

(SOURCE: OECD ECONOMICS AND STATISTICS DEPARTMENT, WORKING PAPER NO.18, JANUARY 1985, "THE OECD COMPATIBLE TRADE AND PRODUCTION DATA BASE")

(1) Since trade statistics are collected on a product and production statistics on an industry basis, the calculation of import penetration ratios requires the reclassification of at least one set of statistics. The OECD has undertaken the production of a compatible data base for a number of countries: 1980 is the latest year for which this exercise has been complete.

The Trade Balance

18. An examination of trade balances can yield information both about long-term structural trends in the various economies and about cyclical developments. Thus those countries - Norway and the UK - which developed oil production in the 1970's show a dramatic improvement in the balance on other (non-manufacturing) trade in goods and services. To some extent this manifests itself in an improvement in the overall

balance on goods and services, ie in a capital outflow, and to some extent in a deterioration in the manufacturing trade balance. The Netherlands, where gas discoveries were made in the 1960's, went through a similar development at an earlier date. Conversely, the counterpart to the Japanese or German surplus on manufacturing trade is an opposite and nearly equal deficit on trade in other goods and services.

19. The trade balance is also sensitive to cyclical developments. This is particularly true of the manufacturing trade balance, which is more sensitive than other trade to the pressures of domestic excess demand on supply. To some extent this shows itself in the figures for the most recent cycle, though other forces were at work as well. The US, which recovered earliest and most strongly moved in the period from 1980 to 1983 from a surplus on manufacturing trade to a marked deficit; this has been offset to a small extent by an improvement on the non-manufacturing balance, leaving a worsened overall trade balance. The UK, which recovered a little later and less strongly, manifests similar but less pronounced trends in the manufacturing and non-manufacturing trade balances. On the other hand, countries such as Germany, Italy and Japan, where the recovery in domestic demand has been delayed, showed a steady improvement in both manufacturing and overall trade balances over that period.

TABLE 7

TRADE BALANCES AS A PERCENTAGE OF TOTAL IMPORTS (CURRENT PRICES)

		1973-79 average	1980	1981	1982	1983
Canada	Manufacturing* trade balance	-19.6	-13.9	-16.0	-8.0	-11.0
	Balance on other goods & services	+20.0	+21.0	+20.6	+26.0	+25.6
	Overall balance on goods & services	+0.4	+ 7.1	+4.6	+18.0	+14.6
US	Manufacturing trade balance	+4.7	+ 7.0	+4.2	-1.8	-10.3
	Balance on other goods & services	-10.3	-14.2	-11.6	-8.2	-8.0
	Overall balance on goods & services	-5.6	- 7.2	-7.4	-10.0	-18.3
Japan	Manufacturing trade balance	+67.5	+61.0	+69.7	+68.7	+78.4
	Balance on other goods & services	-63.6	-67.1	-64.0	-63.2	-62.4
	Overall balance on goods & services	+3.9	- 6.1	+5.7	+5.5	+16.0
France	Manufacturing trade balance	+9.1	+ 4.5	+6.2	+2.2	+5.5
	Balance on other goods & services	-9.2	-11.8	-12.1	-11.2	-8.0
	Overall balance on goods & services	-0.1	- 7.3	-5.9	-9.0	-2.5
Germany	Manufacturing trade balance	+39.7	+27.5	+31.3	+35.6	+32.4
	Balance on other goods & services	-28.3	-29.3	-28.5	-27.0	-25.0
	Overall balance on goods & services	+11.4	- 1.8	+2.8	+8.6	+7.4
Italy	Manufacturing trade balance	+24.5	+15.6	+22.7	+23.7	+28.0
	Balance on other goods & services	-26.1	-25.9	-29.3	-27.2	-25.6
	Overall balance on goods & services	-1.6	-10.3	-6.6	-3.5	+2.4
Netherlands	Manufacturing trade balance	-3.9	- 4.5	-1.0	-0.4	-0.5
	Balance on other goods & services	+8.0	+ 3.5	+5.4	+7.5	+6.4
	Overall balance on goods & services	+4.1	- 1.0	+6.4	+7.9	+6.9
Norway	Manufacturing trade balance	-16.5	-16.3	-18.2	-21.3	-17.4
	Balance on other goods & services	+8.4	+31.1	+38.0	+35.4	+38.8
	Overall balance on goods & services	-8.4	+14.8	+19.8	+14.1	+21.4
UK	Manufacturing trade balance	+9.9	+ 6.4	+5.1	+0.9	-6.3
	Balance on other goods & services	-13.2	+ 3.4	+7.1	+8.2	+10.7
	Overall balance on goods & services	-3.3	+ 9.8	+12.2	+9.1	+4.4

(*defined as SITC categories 5+6+7+8+9)

TABLE 1

VALUE ADDED IN MANUFACTURING* AS A PERCENTAGE OF GDP

	1960	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983**
Canada	23.3	20.4	19.9	20.2	20.2	20.2	19.2	18.6	18.0	18.4	19.1	18.9	18.4	15.6	15.9
United States	28.6	25.7	24.9	24.9	24.9	24.1	23.4	24.2	24.5	24.4	23.8	22.5	22.2	20.9	21.1
Japan	33.9	35.9	35.2	34.5	35.1	33.6	29.9	30.6	30.0	30.0	30.1	30.4	30.4	30.7	...
France	29.1	28.7	28.5	28.2	28.3	27.9	27.4	27.4	27.5	27.2	26.9	26.7	25.8	25.2	25.3
Germany	40.3	38.4	37.0	36.0	36.3	36.1	34.5	34.8	34.6	34.2	34.1	33.0	32.1	32.0	32.1
Italy	28.5	29.0	28.4	28.6	30.0	31.3	29.7	31.7	31.0	30.4	30.6	30.5	29.0	28.3	27.8
Netherlands+	33.6	28.2	27.2	27.1	26.8	25.5	23.7	23.9	20.9	19.5	19.0	17.9	16.9	17.1	17.0
Norway	21.3	21.8	21.1	21.5	21.5	21.9	21.7	20.2	18.8	17.6	18.4	16.0	14.8	14.4	13.8
United Kingdom	32.1	28.1	27.5	28.3	28.4	27.2	26.4	25.5	26.6	26.8	25.0	23.6	21.8	20.9	20.5

*ISIC 3

**Up to 1982 figures are taken from OECD sources. Figures for 1983 are estimates based on national sources and may be subject to revision.

+Figures for the Netherlands are estimates taken from national sources to reflect the exclusion of oil gas extraction from the definition of manufacturing.

TABLE 2

EMPLOYMENT IN MANUFACTURING* AS A PERCENTAGE OF TOTAL CIVILIAN EMPLOYMENT

	1960	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Canada	23.7	22.3	21.8	21.8	22.0	21.7	20.2	20.3	19.6	19.6	19.9	19.7	19.3	18.1	17.5
US	27.1	26.4	24.7	24.3	24.8	24.2	22.7	22.8	22.7	22.7	22.7	22.1	21.7	20.4	19.8
Japan	21.5	27.0	27.0	27.0	27.4	27.2	25.8	25.5	25.1	24.5	24.3	24.7	24.8	24.5	24.5
France	27.5	27.8	28.0	28.1	28.3	28.4	27.9	27.4	27.1	26.6	26.1	25.8	25.1	24.7	24.3
Germany	37.0	39.4	37.4	36.8	36.7	36.4	35.6	35.1	35.1	34.8	34.5	34.3	33.6	33.1	32.5
Italy	23.0	27.8	27.8	27.8	28.0	28.3	28.2	28.0	27.5	27.1	26.7	26.7	26.1	25.7	24.7
Netherlands	30.6	26.4	26.1	25.6	25.4	25.6	25.0	23.8	23.2	23.0	22.3	21.5	20.9	20.5	20.3
Norway	25.3	26.7	25.3	23.8	23.5	23.6	24.1	23.2	22.4	21.3	20.5	20.3	20.2	19.7	18.2
UK	36.0	34.5	33.9	32.8	32.2	32.3	30.9	30.2	30.3	30.0	29.3	28.1	26.2	25.3	24.5

*ISIC 3

Figures for Italy 1960-1976 and 1983 and for the Netherlands 1971-1974 and 1983 are estimtes based on different classifications of employment.

BRIEF 2: INTERNATIONAL COMPARISONS ON MANUFACTURING OUTPUT AND TRADE

Factual

1. Share of manufacturing in GDP declining in all industrial countries, especially since 1970:

Value added in manufacturing as percentage of GDP

	1960	1970	1974	1979	1983
UK	32.1	28.1	27.2	25.0	20.5
USA	28.6	25.7	24.1	23.8	21.1
Canada	23.3	20.4	20.2	19.1	15.9
Japan	33.9	35.9	33.6	30.1	N/A(1)
France	29.1	28.7	27.9	26.9	25.3
Germany	40.3	38.4	36.1	34.1	32.1
Italy	28.5	29.0	31.3	30.6	27.8
Netherlands	33.6	28.2	25.5	19.0	17.0
Norway	21.3	21.8	21.9	18.4	13.8

(1) 1982 figure 30.7

2. Up till early 70's fall reflected fall in relative price of manufactures. Since then volume share has fallen too.

3. Share of manufacturing in total employment has fallen too. About 25% in UK 1983, same as Japan, France, Italy, higher than Canada. Of countries above, only Germany (33%) has higher percentage.

4. UK Productivity growth has lagged behind other major countries (except USA) in past, but significantly higher than other countries in last cycle (both in manufacturing and whole economy).

Annual percentage growth in real value added per head
(Manufacturing)

	1960-68	1968-73	1973-79	1979-83
UK	3.4	3.9	0.7	3.4
USA	3.2	3.7	0.9	2.0
France, Germany, Italy (avge)	6.1	5.3	3.5	1.0
Canada, Norway, Netherlands (")	4.4	4.9	1.7	0.6

5. Exports of manufactures by OECD countries have, however, risen faster than GDP, largely because of trade liberalisation (Kennedy and Tokyo rounds) and increasing international specialisation. Up till mid - 70's, exports of manufactures rose faster than those of other goods and services but since then slower:

OECD output and export volume (annual percentage charge)

	1960-68	1968-73	1973-79	1979-83
Exports of manufactures	7.9	9.2	5.0	2.3
GDP	5.1	4.8	2.7	1.2
Exports of all goods and services	7.3	9.1	5.2	2.6

6. UK share of exports of manufactures and services has fallen (as has Germany's). Share of food and fuel has risen. Japan has gained strongly in both manufactures and services:

Share of OECD exports of manufactures

	1970	1983
UK	9.8	7.3
US	17.8	16.1
Japan	10.9	16.6
France	8.1	8.1
Germany	18.4	17.4

Share of OECD exports of services

	1970	1983
UK	13.9	9.5
US	26.9	26.1
Japan	4.6	7.4
France	7.7	11.6
Germany	10.1	9.3

Share of OECD exports of all goods and services

	1970	1983
UK	10.2	8.5
US	21.5	20.3
Japan	7.5	11.2
France	8.1	9.1
Germany	14.1	12.8

7. Import penetration has arisen in all major countries, for manufactures and for other goods and services. In comparing countries, need to pick countries of similar size (bigger ones naturally have lower import propensities). For total goods and services, Uk was above average for France, Germany and Italy in 1960 but import propensity has grown more slowly, so UK now about average.

Figures for manufactures only available for 1970 and 1980:

Imports of manufactures as percentage of domestic demand for manufactures

	1970	1980	Average annual growth in import propensity (%)
UK	16.2	28.2	5.7
France	16.2	23.3	3.7
Germany	19.3	31.4	5.0
Italy	16.2	32.0	7.0
USA	5.6	9.3	5.3
Japan	4.7	5.8	2.0
Canada	27.0	31.1	1.4

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BRIEF 3 : CHANGES IN THE STRUCTURE OF OUTPUT AND TRADE

Factual

Trade

1. Surplus on manufactured trade declining for many years (for more recent figures see Brief 4). Other elements of current account improving. Current account surplus since 1980 (visible trade also in surplus in 1980, 1981, 1982). Figures below:

Balance of Trade, BOP basis
(ALL FIGURES IN PER CENT OF GDP)

	Agri-culture	Manu-facturing	Oil	Other visibles (basic materials)	Total Visibles	Services	IPD and transfers	CURRENT ACCOUNT
1965-69	-3.1	4.9	-1.1	-1.6	-0.9	0.5	0.5	0
1970-74	-2.6	3.6	-1.7	-1.4	-2.8	1.1	0.8	-0.3
1974-79	-2.1	3.2	-1.9	-1.2	-2.1	2.0	-0.2	-0.3
1980-84	-1.0	0.6	1.5	-0.9	0.2	1.6	-0.4	1.4
1984	-1.1	-1.2	2.2	-1.2	-1.3	1.4	0	0
(1984 adjusted for miner's strike)		(-1.2)	(2.5)		(-0.3)			(1.0)

2. Reduction of deficit in agriculture to do with EC membership, reduction of deficit basic materials reflects lower commodity prices (and reduced importance of manufacturing). Services surplus increased steadily to 1978, then fell back slightly, (milder form of crowding out via exchange rate that affected manufactures.)

3. Similar trends in shares of total exports. Invisibles now contribute almost as much to balance of payments as manufactures:

Share of total exports and other current account credits

	Manu-factures	Fuels	Other visibles	TOTAL VISIBLES	Services	TOTAL INVISIBLES
1963 %	52	2	9	63	23	37
1984 %	43	14	7	64	19	36
1984 £BN	46.7	15.4	8.4	70.5	21.3	38.9

4. Individual industries have moved against trend for their sector. For example, trade surplus in chemicals rose in real terms from 1973-1983 [Figures]

5. Deterioration in manufactures concentrated on textiles, machinery and transport equipment. 60% of deterioration between 1973 and 1983 attributable to transport equipment.

6. Among services, most successful exporters have been banking, construction services, civil aviation and insurance. For some, exports have declined in real terms (eg shipping).

Annual average growth of service exports, 1964-84 at constant prices

	Growth rate (%)	Value in 1984 (£BN)
Sea Transport	-1.4	3.3
Civil Aviation	6.2	3.0
Travel	6.5*	4.2
Insurance	6.2*	
Banking	10.6*	2.9
Other Financial	7.3*	
Construction services	8.6*	7.4
Other	3.6*	
Total service exports	3.7	21.3
Total service imports	1.8	16.9

* To 1983

put

7. Following table gives growth rates of output of different sectors.

Annual average growth of output at constant prices (%)

	1964-9	1969-74	1974-79	1979-84
Manufacturing	3.2	1.8	-0.5	-1.8
Agriculture, Forestry & Fishing	1.1	3.4	0.4	4.7
Construction	2.4	-1.5	0	-1.5
Oil and gas extraction	0	-(2)	300	9(3)
Other energy, mining, water supply	-1.5	-0.8	0.8	-1.5(3)
Services:				
Transport and Communications	2.9	3.8	1.6	0.9
Distribution, hotels & repairs	1.9	2.7	1.1	-0.2
Banking, finance & insurance(1)	4.6	5.4	4.5	6.4(1)
GDP	2.5	2.1	1.9	0.5

(1) Includes leasing, but this is only 8 per cent of the total for the sector. An approximate adjustment to exclude leasing still gives growth of 6.0 per cent in 1979-84.

(2) Too large to be meaningful.

(3) To 1983

8. Manufacturing value added down to 21% of GDP (32% in 1960). Trend common to all major industrial economies (see Brief 2).

Effect of North Sea

9. Rise in North Sea production has coincided with period of slow growth in manufacturing and emergence of deficit on trade in manufactures:

	N. Sea production (m. tonnes)	Index of manufacturing output (1980=100)	Balance of trade in manufactures (% GDP)	Balance of trade in fuels (% GDP)
1976	12	106	3.9	-3.1
1979	78	109	1.4	-0.6
1980	81	100	2.4	-0.1
1981	90	94	1.9	1.1
1982	103	94	0.9	1.5
1983	115	96	-0.7	2.1
1984	126	~~96~~ 99	-1.2	1.7

10. Clear that North Sea did have an effect on manufacturing via upward pressure on exchange rate (manufacturing and services relatively sensitive to exchange rate movements).

But (i) Deterioration in manufacturing trade balance greater than improvement in fuel. Since 1976 manufacturing -5.1% of GDP, fuels + 4.8%. Long-term trend for manufacturing to shrink as share of GDP (Brief 2).

(ii) Not all exchange rate rise due to North Sea. Responsible fiscal and monetary policies post-79. Treasury estimate only 60% of rise from early 79 to early 82 due to North Sea. (1982 Treasury [illegible])

Note: 1985 [illegible]

Positive

(a) Current account has moved into surplus.

(b) As manufacturing has declined in relative importance, other sectors have expanded. For example, banking, finance and insurance, which employs over 1½m people and had a trade surplus of nearly £3BN last year grew at 6 per cent a year between 1979 and 1984. Some sectors have had spectacular export growth. For example, exports of services related to construction and other consultancy work earned us £1400m in 1983 against £200m 10 years ago (£700m in 1984 prices).

Defensive

(a) Need manufactures to pay our way? Have been paying much of our way for years through services and IPD. Will continue to do so.

(b) Services can't be exported? True of some services like retailing. But many export successes in services like banking, consultancy, tourism. Exports of services amounted to £21 BN last year.

(c) Only manufacturing is wealth creating? Wealth or income is generated whenever someone performs a task for which someone else is prepared to pay. To regard the 8 million employed in services as parasitic on the 5½ million employed in manufacturing is to denigrate activities which make a huge contribution to our national income.

(d) Balance of payments crisis when oil runs out? Oil production will run down gradually - see memorandum. May lead to gradual reduction in real exchange rate. This will help balance on manufactures and services, though can't predict which industries' exports will expand. Will also enjoy inflow of IPD from overseas assets built up in recent years.

(e) <u>Insufficient capital investment to cope when oil runs out?</u> Manufacturing investment up 14% in 1984. Latest CBI Survey shows 74 per cent of respondents plan to maintain or increase level of investment in next 12 months.

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BRIEF 4 : OUTPUT AND TRADE OVER THE LAST CYCLE

Factual

1. As in previous cycles, manufacturing output more volatile than total GDP. Fell more in downturn, rose about the same amount in upturn:

Changes in output from previous year (%)

	GDP	Manufacturing	Oil & Gas Extraction	Services including public services)
1981	-2.9	-8.8	1.3	-0.5
1981	-1.7	-6.1	10.3	0.3
1982	2.0	0.6	13.8	1.7
1983	3.0	2.5	9.5	2.9
1984	2.5	3.4	7.0	4.9
Change 1979 QII to 1981 QI	-6.6	-17.7		
Change 1981 Q1 to 1984 Q4	9.7	9.2		

2. Manufacturing employment has fallen steadily since 1977, but levelled off in mid-1984. CBI Survey suggests no further fall in next ~~12~~ few months. Total employment (including self-employed) has risen since the beginning of 1983.

CHECK AGAINST MARCH FIGURE OUT ON 15 MAY

Changes in ~~manufacturing~~ employment from previous year (%)

	Manufacturing(1)	Whole economy (2)
1980	-8.6	-0.3
1981	-7.6	-3.9
1982	-5.3	-1.8
1983	-3.4	-1.3
1984	-0.5	+1.9

[(1) Employees only] (2) Employees and self-employed

3. Manufacturing investment fell till 1983. Rose strongly in 1984. CBI Survey

suggests further rise in 1985:

Changes in volume of fixed investment from previous year (%)

	Manufacturing	Whole economy
1980	-13.7	-5.1
1981	-25.0	-8.8
1982	-3.5	6.7
1983	-1.4	3.8
1984	14.0 ~~16.6~~	7.7

4. Volume of manufacturing exports has risen slowly, with some fluctuations. Import volume has risen quicker. Trade deficit emerged in 1983.

Manufactured Trade

	Change in Export volume on a year before %	Change in import volume on a year before %	Trade balance £BN
1980	0.9	-0.8	+5.5
1981	-5.9	-2.2	+4.6
1982	1.2	8.4	+2.3
1983	-1.9	12.0	-2.4
1984	9.7	9.2	-3.8
1985 Q1	14	7½	-1.2

5. Competitiveness hit by rise in exchange rate up to 1981, and by excessive increases in earnings. Despite productivity gains, unit labour costs increasing too fast. Smaller pay rises would mean more jobs.

Earnings, labour costs and exchange rate : percentage changes on previous year

	Manufacturing		
	Average earnings	Unit labour costs (Sterling)	Effective exchange rate
1980	15.1	23.3	10.1
1981	13.6	2.7	-0.8
1982	9.2	6.3	-4.8
1983	9.7	0.8	-8.2
1984	8.3	2.9*	-5.4

*Q3 on Q3

6. But current account has remained in surplus, though depressed by coal strike last year. Effects of coal strike should cease to affect figures from next month:

	Current account, £BN
1980	+3.5
1981	+6.9
1982	+4.9
1983	+2.3
1984	+0.1*
1985 Q1 (est)	0

*Would have been about £3BN but for coal strike

Positive

(a) Manufacturing output has grown strongly since 1981

(b) Though manufacturing output still below 1979 level, some industries have done better than average. Chemicals and electrical engineering at record level of output 1984 Q4.

(c) Over cycle as a whole manufacturing productivity up by 3½ per cent a year

(d) Employment in manufacturing ~~has~~ stopped falling in second half of 1984 for first time since 1977. In some sectors (chemicals and electrical engineering) employment rising since mid-1983.

(e) Over year to 1985 Q1, manufactured export volume grew 14 per cent, twice as fast as import volume.

(f) Current account in surplus.

Defensive

(a) Manufacturing will never recover from last recession? Some industries producing output at record levels. Others in long-term decline. Must not try to resist structural adjustment of this sort - must respond to new market opportunities.

(b) Unemployment still rising? Employment up 600,000 since beginning of 1983.

(c) Manufacturing employment has not risen? Employment in manufacturing has ~~stabilised~~ been on ~~after~~ downward trend of last twenty years. Recent indications that it may be stabilising.

BRIEF 5

MARCH TRADE FIGURES

Factual

The figures released on 26 April showed:

- a substantial estimated current account deficit of £456 million in March (surplus of £131 million in February), the first deficit since September 1984, made up of:
  - a record visible trade deficit of £900 million (February deficit £270 million) and
  - a slightly larger projected invisible surplus of £444 million.

Positive

(i) Current account in broad balance in Q1 1985 (following £0.6 bn surplus in previous quarter), despite effects of coal strike.

(ii) March should be last month significantly affected by coal strike, though there could be continuing trade effects (eg through stockbuilding).

(iii) Monthly figures very erratic. But export volumes rose 1 per cent in Q1 1985 compared with Q4 1984 (3% excluding "erratics"); and import volumes fell 1 per cent over same period.

Defensive

Why current account deficit in March?

Largest single factor was higher oil imports (up nearly £0.4 billion in March to £1.2 billion), partly reflecting restocking from low end-February levels. But monthly data for both oil and non-oil trade very erratic. Taking first quarter as a whole, current account in broad balance.

Deteriorating current account balance means FSBR forecast optimistic?

Far too early to say if FSBR forecast accurate. Prospects good now coal strike over and broad current account balance in Q1 1985 consistent with £3 billion surplus forecast in FSBR for 1985 as a whole.

Effect of coal strike on trade balance?

Strike directly affected coal and oil trade by (very roughly) £4¼ billion since January 1984, of which about £3½ billion fell on oil account.

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BRIEF 6. SHOULD WE RUN A LARGER CURRENT ACCOUNT SURPLUS?

Factual

1. Current account surplus in recent years in contrast to period before oil built up.

Current account surplus

	1965-69	1970-74	1975-79	1980-84
% GDP	0	-0.3	-0.3	+1.4 [+£3.5b]

2. 1984 + £0.1 BN. Affected by coal strike. 1985 forecast at + £3BN in FSBR (0.9% GDP), continuing at same rate in first half of 1986.

Positive

3. Response to oil has been appropriate. Current account in surplus, permitting build-up of overseas assets which will give inflow of IPD in future when oil has run out. Net assets £12Bn in 1979, £75BN in 1984 (partly due to valuation changes).

4. Government takes full account of effect on current balance when framing macro policy.

Defensive

5. Decision on what to do with North Sea rests largely with private sector in its decisions on saving and investment. Removed exchange controls to enable private sector to allocate NS and other wealth in most efficient way. Could have had a tighter policy stance to achieve a higher surplus, but no need to have done so. This would have depressed output unnecessarily, including manufacturing output.

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CONFIDENTIAL

BRIEF 7 : TRADE POLICY

A. GENERAL APPROACH

B. SPECIFIC ISSUES (GATT, MFA, VRA's)

A. GENERAL APPROACH

Factual

1. Most organisations giving evidence before the Committee have cited protectionism abroad as a reason for UK's decline in manufacturing trade. (CBI is notable exception). TUC wants exchange controls and selective import controls, while BL, Ford, the British Clothing Industry Association, and the British Textile Confederation all want quantitative constraints maintained for their own sectors.

2. Government policy supports free trade. Protectionism causes misallocation of resources between countries and between different industries.

3. Often protection so distortionary that it would benefit the protecting country to dismantle its import controls unilaterally - jobs created in unprotected industries, especially exporting sector, would more than outweigh jobs lost in protected industry. The Silberston report reached this conclusion on MFA; OECD's Michalski report provides extensive evidence from many countries that protectionism has yielded few benefits but imposed substantial costs on protecting country itself.

4. Nonetheless, generally pursue multilateral approach, using our controls as bargaining counter.

Recent Trends

5. In recent years protective measures outside GATT discipline have multiplied - voluntary restraint agreements - (VRA's), grey area measures, industrial support. While

'traditional' tariff protection scaled down non-tariff barriers (NTB's) more pervasive.

6. OECD 'standstill and rollback' initiative only partially successful. No appreciable impact in scaling down NTBs, and accelerated introduction of Tokyo round measures not fully implemented. In US, current account deficit has led to calls for wide-ranging protectionism, including an import surcharge (hence US Administration keen for new GATT round).

Positive

(a) Government working energetically in international fora (GATT, OECD, EC) for multilateral reduction in protectionism.

(b) Recent success : Consensus agreement in 1983 to bring minimum interest rates for export credits more in line with market rates - multilateral reduction in subsidy. Progress on mixed credits at April OECD Ministerial (see Brief 8).

Defensive

(a) Why not protect industries threatened by overseas competition? Protectionism invites retaliation (so ineffective), damages other sectors more than helps protected sector, raises price paid by consumer. With VRA's main benefit is to overseas producers (can raise prices and profits).

(b) Why not match others' protectionism? In some cases we do - eg mixed credits and export finance. But must not encourage escalation to trade war : must pursue multilateral disarmanent. Particularly sensitive time now new GATT round in prospect : must not damage prospects of mutually beneficial negotiations.

B SPECIFIC ISSUES

Factual

1. GATT round. Prime Minister announced UK commitment to a new round in her speech to US (20 February). EC indicated readiness to participate (19 March). OECD Ministerial (12 April) gave more positive welcome and made procedural progress - especially in proposing preparatory talks in GATT before end of summer. But developing countries wary. At Washington spring meetings (18 19 April), Development Committee communique referred only to completing 1982 GATT work programme, which "could lay the basis for a general participation of all countries in the trade negotiation round on which, it was noted, a number of countries have decided to embark under the auspices of GATT". [Bonn Summit (2-4 May...]

2. Overriding UK interest is maintaining healthy multilateral trading system. Own objectives for progress in new GATT round are:

   (a) liberalisation of trade in services;

   (b) bringing trade in agriculture more fully under GATT discipline;

   (c) graduation of NIC's into acceptance of GATT obligations as well as rights;

   (d) effective opening of the Japanese market to imports of manufactures;

   (e) reducing peaks in developed country tariffs.

3. <u>MFA.</u> MFA allows bilateral import quotas on clothing

and textiles. Current version expires July 1986. Discussion on whether to extend, modify or discontinue it will be held in GATT in July 1985. DTI commissioned report on effects of MFA on UK by Prof. Silberston. Came out against extension of MFA. NOT FOR USE The UK's position was discussed at E(A) on 25 April; it concluded that:

(a) a new, more liberal MFA should be negotiated;

(b) major liberalisation should be held back for the GATT round negotiations.

Debate on MFA to be held in House of Commons, probably in early May.

4. British Clothing Industry Association and British Textile Confederation, in evidence to Committee, blamed decline of their industries on:

(a) state aids in other EC countries

(b) growth of cheap imports from LDCs into EC (MFA allows some growth).

5. <u>On state aids</u>, considerable growth of major sectoral aid schemes in other EC countries. UK industry has received £285 million from Government in last five years, but other EC governments more generous. UK Government argues state assistance not in best long-term interests of Community. Pleased that Commission now looking for <u>total ban on sectoral aid</u> to these industries in near future. Has already put more restrictions on Belgian and Dutch schemes. UK Government has also expressed concern about subsidies available in other EC countries towards cost of pollution control investment.

6. <u>On imports from LDC's</u> MFA has become more restrictive over its life. Import growth rates reduced. LDC's import

penetration has increased, but recently growth in imports from rest of EC more important. Portugal's accession will exacerbate this.

7. VRA's UK's VRAs are industry-to-industry agreements to limit quantity of imports. 23 VRAs covering 10 different products (list attached). Also VRAs negotiated by EC. VRAs do not conform with GATT, but have proliferated in recent years. [NOT FOR USE: In recent discussion at E(CP) (22 April) it was agreed that:

(a) in line with Government's overall competition policy, onus of proof on those who wish to retain VRAs;

(b) DTI should review each of UK's VRAs, with industry's knowledge and assistance.

(c) DTI would then decide whether to maintain or withdraw its support for them, case-by-case.]

Positive

(a) UK strongly support new GATT round. Useful progress made in international meetings to gain support. New round essential to maintain healthy multilateral trading system.

(b) In new round UK would expect some trade benefits but also to make some concessions. Freer trade allows all countries to be better off simultaneously.

Defensive

(a) Retain/strengthen MFA Silberston report suggested that price of supporting textiles and clothing industry through MFA paid for by UK consumers and other UK industries. Silberston concluded that jobs preserved in textiles and clothing might be more than outweighed by jobs lost in other industries. Government consulting widely with interested parties about future of MFA.

(b) Retain/strengthen VRA's? Primarily agreements between industries. But Government not indifferent. As with MFA, benefit one industry but impose costs on others and on consumers. Need to be convinced in each case that benefits outweigh costs.

(c) Government/Silberston has no idea of problems facing industry when other countries give subsidies/protection? Of course those in industry concerned best placed to gauge impact on their own industry. But Government has wider responsibilities - to unprotected sectors, to taxpayers, to consumer. Inevitably will take different view in some cases when all these factors weighed up.

BRIEF 9 : ECGD

A. **Financial problems.**

B. **Market limits**

C. **Turkey, Nigeria, Oman.**

D. **Fixed-rate export finance Report.**

A Financial Problems

Factual

1. ECGD's activities two-fold: subsidised export finance from public expenditure (see section D) and credit insurance for UK exporters. This latter operated as trading activity, for which premium is charged, and on which ECGD is expected to operate at no net cost to public funds.

2. International debt crisis has brought unprecedentedly high level of claims on ECGD, which have put it into deficit with the Consolidated Fund for the first time since early 1950s. ECGD's accounts for 1983-4 record deficit of £148m - first ever. PAC, who, along with Trade and Industry Select Committee, examined ECGD recently, were told that cash deficit might rise as high as £1 billion over next few years. More recent (unpublished) forecasts put cash deficit even higher (almost £2 billion) mainly because of Nigeria.

NOT FOR USE

3. Measures in hand to minimise future losses:

- more rigorous approach to market limits since 1983 (see section B);

- loss making facilities (tender to contract cover, comprehensive external trade, short term bank guarantees) under scrutiny;

- Corporate Plan being prepared, (to Ministers early July);

- internal Management Review, due to report early May, will recommend ways in which ECGD might be run more efficiently, and provide better service to exporters.

But bulk of projected claims and hence impact on public finance arise from past business which ECGD cannot affect.

B. **Market Limits**

Factual

1. Limits on ECGD's total exposure set by Statute, currently £40 billion for sterling guarantees and SDR 25 billion for foreign currency guarantees. Limits on individual markets on Section 2 (national interest) account set and periodically reviewed by Export Guarantees Committee - interdepartmental committee under Treasury chairmanship. Necessary to protect ECGD's financial position. Limits on commercial account, Section 1, set after consultation with Export Guarantees Advisory Council (EGAC) consisting of independent businessmen.

2. Market limits set for all except countries like US, Japan, France, Germany. The Limits take account of economic prospects of country in question, ECGD's claims experience, and potential demand for cover for UK exports. More cautious approach since 1983 in riskier markets.

3. No market limits on short term business (credit terms

of less than 12 months). Control exercised by altering security required.

4. Market limits can be altered up or down. In practice, pressure almost always upwards. Cover suspended for new business as soon as a country applies to Paris Club to reschedule. Traditionally, cover not resumed until country judged to have completed successful adjustment of economy. Recent relaxation, as you announced last autumn at Bank/Fund meeting in Washington, and as Mr Channon announced to House on 21 November. Where country is making serious adjustment effort, ECGD may maintain cover or resume it earlier to support credits for goods contributing to recovery. So far, this provision has been applied only to Mexico.

Positive

(a) Government taking steps to stem ECGD's losses and achieve purpose of running insurance activities at no net cost to public funds.

(b) Recognising need to encourage adjustment by debtors, ECGD may now resume cover at earlier stage than in past.

Defensive

(a) Treasury preventing ECGD providing cover for markets where UK exports in demand?
Have to balance support for exporters with need to prevent ECGD trading at a loss. No point winning exports for which customer never pays. Severe debt problems of some countries has necessitated withdrawal or restriction of cover.

(b) Treasury view to short term? Difficulties of many debtor countries not temporary. Excessive borrowing has left them with huge backlog of debt.

(c) ECGD more restrictive than equivalents in other countries?

May take different view of particular markets, but overall approach of other agencies is the same as ours.

C. **Difficult Cases**

Factual

NOT FOR USE

1. Tornados for Turkey ECGD was asked in Summer 1984 to provide cover for 40 Tornado planes to Turkey. Original terms involved ECGD in exposure of £560 million, but this reduced to £200 million after private sector agreed to share risk. Case discussed at OD on 22 October 1984, and rejected by Cabinet on 1 November.

2. Since then letters from Sir Frederic Bennett, MP and John Wilkinson, MP, argued on strategic, industrial and employment grounds for reversal of decision. Lord Hatch of Lusby mentioned case when Treasury Officials gave evidence in December. Article in Mail on Sunday alleged that Chancellor was to blame for denying cover and that this would prevent this and other Tornado exports. Also suggestions of damage to our relations with Turkey and Turkey's role in NATO. However, Turkish Cabinet as a whole never authorised deal. You have made this point in letter to Sir Frederic Bennett.

NOT FOR USE

3. Cover for two other Turkish projects agreed at EX on 13 February. (a) Akkuyu nuclear power station involves ECGD in Departmental Maximum Liability (DML) of £44 million. Risk sharing with DTI is being considered but unlikely to be feasible. (b) Second Bosphorus Bridge (DML of £27 million) now lost to Japanese (see Brief 8). ECGD's maximum permitted liability for Turkey as a whole is £253 million. This is fully committed.

4. Two other cases involving Tornados recently in public eye. These details should not be disclosed.

NOT FOR USE

(a) Saudi Arabia. No application for ECGD cover or credit has been made. Subject of separate negotiations involving MOD;

(b) Oman. ECGD has agreed cover, but Treasury is resisting extent of interest rate subsidies proposed.

5. Nigeria is an unusual debtor country. Has so far met medium and long term obligations. But arrears on short term debts built up in 1983 because of insufficient foreign exchange from oil exports. So ECGD (and other credit insurers) have paid claims. In last financial year ECGD paid out £204 million. Nigeria agreed with uninsured creditors to reschedule these arrears but a Paris Club rescheduling of officially guaranteed debt held up by Nigeria's unwillingness to reach agreement with IMF. Meanwhile, ECGD have suspended all medium-term cover for new business and have made short-term cover available only to existing business on very restrictive terms. Payments due under these transactions are being made. Other major credit insurers have taken restrictive action to encourage Nigeria to reach agreement with Fund and re-establish creditworthiness. But inevitably allegations that one or other major country prepared to give new credit and UK exporters losing out.

Defence

(a) Why did ECGD not give cover for Tornados to Turkey? For reasons of commercial confidentiality, it is not practice to discuss details of individual cases. Can say that consequences for industry, employment and international relations give given full weight in decision. ECGD's duty to operate at no net cost to taxpayer means some applications must be reluctantly refused.

(b) Will cover be given for Oman? Cannot comment (as above).

(c) Will cover be given for Saudi Arabia? ECGD have not been approached for cover or credit.

(d) UK being obstructive over agreeing rescheduling with Nigeria/resuming cover? Essential that Nigeria agrees recovery programme with IMF. No Paris Club deal till then (normal practice). No question of UK acting unilaterally and undermining international co-operation vital to solution of debt problem as a whole

D. Fixed Rate Finance and Byatt Report

Factual

1. To encourage exports and help exporters against foreign competition, ECGD enables exporters to offer credit at fixed rates of interest to foreign buyers. Guarantees loan of financing bank and pays bank difference between fixed rate paid by buyer and bank's cost of funds, (plus margin). Exporters at present have open access to fixed rate finance for exports insured with ECGD on terms of more than 2 years. Cost was £428 million for 1984-85. PEWP figures (on an accruals basis) for future years are £200 million for 1985-86, £70 million for 1986-87, and -£50 million for 1987-88. More recent estimate, reflecting changes in interest rates, suggest higher figures and cost remaining positive for longer.

2. Minimum fixed rates set by International Arrangement on Export Credits ("the Consensus"). Vary according to country of buyer. Countries divided into 3 categories, rich, intermediate and poor. 1983 agreement reduced subsidy element. Minimum Consensus rates now adjusted every 6 months according to an automatic formula to reflect significant changes average of international interest rates. Formula designed so that buyers in

rich markets pay rates of interest closest to market rate. For currencies with commercial interest rates below Consensus matrix export credit agencies allowed to offer exporters fixed rate finance at LIRC (low-interest rate currency) rate of 0.2% higher than relevant commercial interest reference rate (CIRR).

3. In December 1982 report (since published) by interdepartmental group of economists on "the costs and risks of support for capital goods exports" (Byatt Report) concluded that:

(a) no a priori reasons for discriminating in favour of capital goods sector by providing a general subsidy to its exports;

(b) untargeted nature of FREF makes it inefficient way of helping domestic industry;

(c) export credit subsidies expensive way to reduce unemployment;

(d) fact that other countries may subsidise capital goods exports does not necessarily imply that it is correct to match them regardless of cost;

(e) little evidence that subsidised capital goods exports generate significant unsubsidised follow on orders.

4. NEDO have attempted to challenge conclusions of the Byatt Report, which Treasury Ministers broadly accept, but, so far, NEDO have been unable to produce compelling evidence. Recent NAO Report on FREF gave indirect support to Byatt. Condemned expenditure of £3 billion on FREF over 10 years because no evidence that expenditure necessary to secure overseas orders or that it was of benefit to economy.

5. Bank of England and Treasury together examining case for private sector Export Bank.

Defensive

(a) Government planning to scrap support for capital goods exports? Works for multilateral elimination of subsidies. Progress made on Consensus interest rates in 1983 and on mixed credits this year.

(b) Byatt Report out of touch with realities of exporting? Accept broad conclusions of Byatt Report. Right to point out that public expenditure in support of one industry imposes penalties on others. Exports supported by fixed-rate finance less than 3% of our total exports (5% of manufactured exports). Why single out capital goods? Byatt-inspired thinking has contributed to changes in Consensus agreement, which reduced cost to taxpayer without harming competitiveness of UK exporters.

(c) Better to have an Export Bank? Government examining whether private sector Export Bank might offer advantages through cheaper export finance to both exporters and taxpayer. Departments also exploring informally ways of using recent developments in capital markets to help exporters by providing cheaper finance.

12/1246

BRIEF 10 : EC MATTERS

A. Internal Market B. Spanish import restrictions

A. Internal Market

Factual

1. UK seeking with Netherlands to make major progress during UK and Dutch Presidencies in 1986. DTI lead department.

2. Commission under Delors making internal market a major theme. Work programme for 1985 includes:

(a) reduced frontier formalities - eg the Single Administrative Document.

(b) better harmonisation of industrial standards.

(c) reform of Government policies which distort competition, eg state aids to industry.

3. UK supports Commission's programme (DTI have some reservations)
EXCEPT proposal to harmonise indirect taxes. Took initiative at European Council in March. Called for removal of obstacles to free movement of goods.

4. On standards UK again pressed Community and progress being made. Aim is mutually acknowledged standards in place of national ones. But careful not to place new bureaucratic burdens on business. Pressed this at Council too.

5. Council's conclusions called for single unified market by 1992 and for strengthening of Europe's technological base and competitiveness. Accepted need to reduce

bureaucratic burdens.

Commission will assess all new proposals against this criterion.

Positive

(a) UK in forefront of EC efforts to remove artificial barriers and unify markets.

(b) Much of progress at March European Council thanks to UK pressure.

(c) Will pursue energetically during our Presidency.

Defensive

(a) UK resisting harmonisation of indirect taxes? Do not accept this is needed to unify internal market. USA manages with differing state sales taxes. Must remain responsibility of national governments.

B. Spanish import restrictions (effect of Spanish membership)

Factual

1. BL, in evidence to Committee, argued Government should seek earliest possible removal of trade barriers to car and commercial vehicle exports to Spain.

2. Spain's restrictions on imports of manufactures are currently stringent. Tariffs on imports of industrial goods from EC at rates around 15-25 per cent, but 36.7 per cent for cars. EC tariffs on imports from Spain 4 per cent for cars, and close to that figure on other goods. Spain does however allow a fixed number of cars to be imported from EC at lower duty rates - 25 per cent on 10,000 cars of 1990-2600cc, and 19 per cent on 5,000 cars of 1275-1600cc.

3. Agreement reached on 18 December 1984 between EC and Spain on timetable for phasing out Spanish industrial tariffs on Spain's accession to Community. With agreement on accession at European Council (29-30 March) this timetable will now take effect, subject to formal ratification of accession treaty by national Parliaments. Tariffs will be reduced in both directions as follows:

1.3.86	10%
1.1.87	12½%
1.1.88	15%
1.1.89	15%
1.1.90	12½%
1.1.91	12½%
1.1.92	12½%
1.1.93	10%

These figures given in a written PQ by Mr Channon on 19 December 1984 to Mr Keith Speed.

4. In addition Spain's reduced duty quota for car imports from EC will be raised to:

1986	32,000
1987	36,000
1988	40,000

at a duty rate of 17.4 per cent, compared with an average rate of 23 per cent under existing quota. Of these quotas, 2,000 cars specially allocated to the UK. [NOT FOR USE: In addition Mr Channon negotiated a confidential deal for higher reduced-duty quotas for the UK. These higher quotas are (including the 2,000 made public):

1986	5,000
1987	6,000
1988	7,000

And for 1985 Spain would give the UK an allocated of

3,620 cars (at an annual rate) for the second half of the year. This compares with an allocation for Austin Rover of 2,240 cars in 1984/85 and 1,997 in 1983/84.]

Positive

(a) negotiations on Spanish accession have produced very satisfactory deal on phasing out industrial tariffs;

(b) tariffs (in both directions) will be phased out over a seven-year period, with rates being more than halved in the first three years;

(c) British exporters (especially car manufactures) will not only gain from tariff rate reduction. Reduced-duty quotas on car imports to Spain are also being raised substantially. Although UK guaranteed only 2,000 reduced-duty exports in 1986, confident that UK will in fact get around 5,000 in 1986, rising appreciably in later years;

(d) reduced-duty tariff rate on cars being lowered from 23% to 17.4%;

(e) Spain's entry means 40 million extra customers for UK exporters' "common market".

BRIEF 11 : EXCHANGE RATE POLICY (INCLUDING EMS)

Factual Background

* In evidence to HL Committee a number of witnesses (CBI, Clothing Industry Association, Textile Confederation) referred to difficulties that industry faced because of sterling's volatility. The TUC say that Government policies had produced an overvalued exchange rate, and exchange controls should be reintroduced.

* Recent exchange rate movements

	£ ERI	£ ERI (ex $)	$/£	DM/£	DM/$
Jan	71.5	79.9	1.13	3.58	3.17
Feb	71.3	80.5	1.09	3.61	3.30
March	73.4	82.9	1.12	3.70	3.30
Latest rate (26 April, opening)	76.3	85.4	1.20	3.78	3.14

* Sterling now up 9 per cent in index terms, 16 per cent against the dollar and 8 per cent against the deutschemark compared with the respective low points reached earlier in the year (70.0 and $1.0357 on 26 February and DM 3.50¼ on 14 January).

* Dollar has fallen 10 per cent against the deutschemark and 14 per cent against sterling since its 26 February high point (DM 3.47 and $1.04).

* At time of G5 Washington agreement (17 January) dollar stood at DM 3.18 and $1.1201 against the £.

* TCSC report on exchange rate policy published 6 March. Criticised authorities for confused policy and said it was increasingly implausible to say that the Government had no target or floor for sterling.

* TCSC report on Budget published 26 April. Claimed that exchange rate is now of increased importance in policy and Government should clear up alleged confusion by admitting, and explaining, the change in policy.

* On 19 October 1983 CBI Council said time was not ripe for full EMS membership (at that time sterling was 83.3, $1.50, DM 3.88). On 20 February 1985 CBI changed policy to support UK membership of ERM (when sterling was 71.4, $1.09, DM 3.62).

174/29

Line to take

* Exchange rate policy set out in every FSBR since March 1981. Government always recognised that exchange rate is important. Benign neglect is not an option. Necessary to judge appropriate combination of monetary growth and exchange rate needed to keep financial policy on track. No mechanistic formula.

* Key to reducing exchange rate volatility is prudent domestic policies. Major industrial partners committed to this approach which the UK has followed consistently, through MTFS.

* Present level of sterling/dollar rate still provides excellent opportunities for industry to win markets overseas.

* But key to competitiveness is responsible pay bargaining, increased productivity, better efficiency all round (product quality, meeting delivery dates etc). Growth in UK unit labour costs (of around 3 times rate of major competitors) more than accounts for 25 per cent loss of competitiveness since 1975. Artificial depreciation of currency, through lax policy, not a responsible option.

* Forward and option markets can be used to reduce uncertainty of short term exchange rate movements. ECGD tender-to-contract service also available.

* Membership of ERM not soft option. Present circumstances - dollar and oil price uncertainty - not appropriate for immediate participation. DM/£ exchange rate moved sharply recently eg on 24-5 April it fell 2 per cent largely on expected oil price developments.

* UK committed to objectives that EMS seeks and plays full part in general developments. Goal of monetary stability best served by further general convergence of policies and performance and liberalisation of capital movements.

* EMS no guarantee against speculation, dollar gyrations or other sharp exchange rate movements because of EMS realignments. Less flexible exchange rate system could involve greater burden of adjustment falling on interest rates.

BRIEF 13 ~~10~~. INDUSTRIAL SUPPORT - COMPARISONS WITH OTHER COUNTRIES

FACTUAL

No authoritative comparison of overall industrial support in different countries - too many different forms of more or less transparent aid.

2. Recent years emphasis moving away from regional assistance towards encouraging innovation. In 1985/6 regional policy measures (£271m) will account for 30 per cent of DTI's financial assistance to industry (excluding nationalised industries) compared with 48 per cent in 1980/81, while the share of scientific and technical assistance (£446m) will have risen from 17 to 51 per cent. Other industrial assistance (£165m) will account for 19 per cent. Most of this assistance going to manufacturing industry.

3. **Innovation - R&D - particular concern.** Correct that the UK's R&D performance not good. After real increase between 1975 and 1981 expenditure by both UK industry and Government fell between 1981 and 1983. On international comparisons, UK devotes smaller share of GDP to civil R and D than main competitors and since our GDP lower than theirs, in absolute terms UK civil R and D effort even further behind. Also much more of Government support goes on defence R and D and much less on civil R and D than our competitors.

POSITIVE

- Government policies creating climate conducive to risk-taking and innovation. Since 1979-80 DTI support for industrial R&D increased threefold. The good response by industry (which lead to the moratorium) evidence of greater awareness of importance of R and D;

- the increasing emphasis to be placed in DTI support on consultancy and advisory programmes (aimed at improving awareness of best practice) and collaborative research should help reinforce this - their share of total Support for Innovation to rise from 25 per cent to 45 per cent over next three years.

DEFENSIVE

- Not aware of any authoritative comparative study of overall industrial assistance in different countries. Assistance in myriad forms - direct grants, cheap loans, regional aid, tax allowances, finance for publicly-owned industry and so on - where exact amount of subsidy arguable. In UK support usually in form of grants directed mainly at regions, employment and training though recently more emphasis on innovation.

- agree that UK's R&D performance has not been ideal but onus on industry to improve. Signs are that industry now more aware of importance of R&D for overall performance. New, improved, Support for Innovation scheme should help. With rising profitability and move out of recession hope to see an increase in R&D activity;

9/1246

BRIEF 14 : INFRASTRUCTURE SPENDING

<u>Factual</u>

1. CBI has argued, in evidence to this Committee and elsewhere, for increased investment in infrastructure. Not as way to raise employment but to improve supply side. eg Sir James Cleminson (evidence before this Committee, 28/11/84):-

   "...we believe in order to be competitive it is very important that there should be increased expenditure on the infrastructure, but not in itself in order to provide jobs, although inevitably it will do so, thankfully, but we are at a disadvantage as a manufacturing nation because of the fact that so many of our roads point north-south instead of to the east coast ports....and because of a dilapidated running down of infrastructure which is not being rebuilt fast enough."

2. CBI claims transport costs per tonne-mile in this country twice as high as in Europe. Argue that deteriorating infrastructure is hitting competitiveness, vis distribution costs.

3. "The Fabric of the Nation", (July 1984) CBI urged Government to spend additional £1 billion a year on development of infrastructure, in particular, roads, urban renewal and waterways. To be financed from fiscal adjustment and from efficiency savings or current expenditure (easier said than done).

4. Other proponents (eg TUC, some MP's) have argued mainly on basis of number of jobs created. Two main issues:

   (a) claim that spending on infrastructure creates more jobs than tax cuts,

   (b) 'cost per job' of expenditure on infrastructure.

Infrastructure versus tax cuts

5. In short term, (eg 1-2 years), £1 billion of tax cuts probably produces smaller rise in employment than £1 billion of additional public expenditure. Part of additional personal disposable income from tax cuts and, of the rest, larger proportion likely to go on imports than for additional public expenditure.

6. But these mainly effects of higher demand, which will only raise jobs in short-term. Crowdin-out via inflation and/or interest rates. Case for tax cuts rests on supply side improvement through increased incentives, moderating influences on wages and better rewards for enterprise and effort.

7. Such effects difficult to quantify. Not fully captured in most macroeconomic models, including the Treasury's. Models which do take incentive effects into account agree that tax cuts create more jobs than public investment (eg Liverpool model). However this is still an area of controversy.

Cost per job

8. Prime Minister quoted in the House*two estimates of 'cost per job' - £47,00 for central government investment and £37,000 for local authority housebuilding (much higher than cost per job of Special Employment Measures). These figures challenged by Civil Engineering EDC, who quote estimate by Henley Centre for Forecasting (using Treasury model), who estimate first year cost at £10,000. Main reasons for difference are:

   (i) different assumptions about import and labour contents of infrastructure spending.

   (ii) different assumptions about monetary policy.

   (iii) use of employment rather than unemployment for calculating 'cost per job'.

* 9th January

A note by the Treasury is current/has been prepared for the EDC, explaining in more detail how our 'cost per job' numbers were obtained.

<u>Postive</u>

(a) Important thing is investment in economy as a whole. Total fixed investment - public and private sectors together - at all time record in 1984 (in real terms). £55BN at current prices. Forecast to remain buoyant in 1985 [CBI survey].

(b) Public sector spending substantial amounts on infrastructure. No magic number for right level. Each investment project should be judged on its merits, particularly for supply-side contribution. Agree with CBI on this.

(c) In some areas Government making room for public sector infrastructure spending. In others right course is to make room for private sector by reducing Government's claim on funds available for investment (eg housing). Privatisation contributes to this.

<u>Defensive</u>

(a) <u>Not enough capital spending?</u>
Government stands by record on capital spending. Sits positively with policies to control total public expenditure and borrowing in order to achieve lower inflation and cut taxes. Strategy for sustained growth and lasting jobs. More public spending now - capital or current - would jeopardise these objectives.

(b) <u>Capital spending would have supply-side benefits?</u>
In some cases, yes. But would displace tax cuts which are vital to stimulate enterprise and initiative and thus economic growth.

(c) Capital spending creates jobs?

Admittedly, higher capital spending can boost employment in short run. But gain dissipated by higher interest rates/inflation. Even in short run, employment and training measures - current expenditure - have bigger impact per £ spent. Budget announced provision for expansion of these (Community Programme up from 130,000 to 230,000, YTS to give second year for 16-year-olds and one year for 17-year-olds - see Brief 16).

(d) Not cutting current expenditure/inefficiency in Government?

Already holding down current expenditure where possible. Seeking better value through FMI. Civil Service numbers down 15% since 1979.

(e) Foolish not to do projects which need doing while unemployment high?

Within public expenditure totals, Government making provision for projects with high expected return. If spending on infrastructure added to total public spending, strategy would be undermined.

7/1246

BRIEF 15 : 1984 BUSINESS TAX REFORM

Factual

1. Balanced package : phased elimination of incentive capital allowances and immediate abolition of stock relief balanced by phased reduction in corporation tax rates and immediate abolition of National Insurance Surcharge.

2. Capital allowances : main changes:-

- phased abolition of first-year allowances for plant and machinery : 50 per cent in 1985-86 : 25 per cent writing down allowance only from 1986-87 onwards

- phased abolition of initial allowances for industrial buildings : 25 per cent in 1985-86 : 4 per cent writing down allowances only from 1986-87.

- consequential changes to minor capital allowances (hotels, agricultural buildings etc) in 1985 Finance Bill : but scientific research allowance retained at 100 per cent.

3. Corporation tax rates reduced in stages from 52 per cent to 35 per cent in 1986-87 (40 per cent in 1985-86). "Small companies" rate - where profits below £100,000 - reduced to 30 per cent immediately.

Positive

(i) 1984 business tax changes designed to

- bring capital allowances closer to economic depreciation and so reduce distortions and improve quality of investment.

- reduce bias towards capital spending, against jobs.

- improve incentives and so encourage investment in genuinely profitable projects.

(ii) 1985 Budget confirms basic structure of 1984 reforms. But some worthwhile refinements, for manufacturing notably

- special provision for shortlife assets : particularly helpful to firms reequipping with new technology.

- retention of 100 per cent scientific research allowance (subject to minor changes) : recognises special case for high-risk, "front-end" spending.

Defensive

(i) Reform hits manufacturing/investment?
Inevitable that removing distortions means some gainers and losers. Prior to change, investment in plant and machinery effectively subsidised. Main changes phased in to ease transition. Reform may hit some projects with low or negative pre-tax returns : but will encourage others with better returns. Overall effect should be improved quality of investment.

(ii) Transitional "dip" in allowances for manufacturing?
(CBI point) Emphasis on "dip" in allowance misleading : wrong to focus only on allowances, leave out of account lower CT rates. Note also continuing benefit of NIS abolition - worth over £900m to business in a full year. Companies' finances generally sound, and no case for general relaxation in 1984 reform

programme : transition already spread over four years.

(iii) Higher capital allowances for plant and machinery

(eg CBI's 25 per cent straight-line)? Would be a major change in the balance of the 1984 package and reintroduce significant tax incentives for most assets : runs counter to aim of reducing distortions, subsidy and bias against labour. Provision this year for genuine special cases-eg short-life assets, scientific research.

(iv) Reform means higher tax bills?
ONLY IF RAISED : No reason to change last year's assessment that the effect of the 1984 tax package on business would be broadly revenue-neutral over the transitional period as a whole. Other changes in 1984 - eg NIS abolition - and in 1985 show clear gains for business.

(v) Unincorporated business lose?
Accept they do not benefit from CT rate cuts. But changes this year - Class II NIC reduced, tax relief for Class IV - worth £155m to self-employed in a full year.

8/1246

BRIEF 16 : EDUCATION AND TRAINING

Factual

1. In France and Germany 80 per cent of school leavers get training/further education. In UK 60 per cent.

2. White Papers : 1981 "A new training initiative"; 1984 "Training for jobs"; 1985 "Education and training for young people" and "Better schools".

3. Government acting across wide field : schools, other educational establishments, employers, MSC. Seeking to improve quality of recruits entering industry by changes to school curriculum, increase vocational training in industry (replacing outmoded apprenticeship system). Encouraging employers to spend more on training and trainees to accept lower wages.

Positive

(a) Government spending £1.2BN on training in 1985-6.

(b) Progress in modernising apprenticeship system.

(c) Doubling number of adults on MSC training programmes to 250,000 in 1986-7 (includes 125,000 unemployed).

(d) Set up Open Tech to make flexible training facilities widely available. Will reach 50,000 people in 1986-7.

(e) Over 160 IT Centres now teach young people computing and electronic assembly skills.

(f) £38M for Technical and Vocational Education Initiative, which is assisting changes in curriculum for ages 14-18. (61 education authorities).

(g) Closer employer/school links

(h) 700,000 have had YTS training. Extended in Budget to offer second year to 16-year olds, one year to 17-year-olds. Government prepared to put in £300m in 1987-8.

(i) Budget also announced £40m for special programme to produce more graduates in engineering and technology.

RESTRICTED

F 2 APR 1985 9

Mr Ellis

From: J B UNWIN
2 April 1985

I was surprised by this. It is some time ago now, but I am [illegible] let you know my self - though not in writing. ~~[illegible]~~ ~~[illegible]~~ RE. 9/4

CHANCELLOR OF THE EXCHEQUER

Mrs Lomax O.R.

R. H wd. have been good to know about this. Not (just) cause - people the E-S-Sec. have undertaken to put his foot in it in speaking to members of the Cttee. AG 2/4.

cc Chief Secretary
Economic Secretary
Sir Peter Middleton
Sir Terence Burns
Mr Littler
Mr Monck
Mr Battishill
Mr Fitchew
Mr Lavelle
Mr Mountfield
Mr Sedgwick
Mr Beastall
Mr Culpin
Mr Mowl
Mr Aaronson
Miss Henderson
Mr Walker

HOUSE OF LORDS COMMITTEE ON OVERSEAS TRADE

I understand that you have agreed to give evidence to this Committee on 15 May. So far as we know, you and Mr Tebbit are the only Ministers to have been invited. We believe they are aiming to publish a Report in July

2. I have been discussing with Mr Sedgwick, who appeared before them last year, and others how best we can help you on the briefing. If you are content, we will aim to get you a full set of briefs by Friday 3 May. This will leave a week for any discussion here and mopping up new points in the light of any advance intelligence on questions from the Committee (remember that you are due to be at ECOFIN in Brussels on Monday 13 May). I thought, however, that in the meantime it might be helpful to give you an indication of the areas we are proposing to cover. These are as follows.

Trade Policy

3. Your task ought to be confined to setting out the Government's general approach to trade policy, and in particular to export subsidies and provision of ECGD cover. If the forthcoming international meetings - in particular the OECD Ministerial and the Bonn Summit - lead to suitable further expressions of international agreement on trade policy (including a new GATT round and mixed credits), you may be reasonably well placed to show that the Government policy of multilateral scaling down of protection and export subsidies is having some success.

RESTRICTED

MR H DAVIES

FROM: P WYNN OWEN
DATE: 7 MAY 1985

HOUSE OF LORDS SELECT COMMITTEE ON OVERSEAS TRADE

As preparation before his meeting before the House of Lords Select Committee on Overseas Trade next week the Chancellor would be grateful if you could prepare, as soon as possible a full list of the Members of the Committee with all their industrial and commercial interests listed.

Pwo,

P WYNN OWEN

M/S* as % of GDP
as % of employment

* 1983 value-added
to 20½% (cf US 21%)
[illegible] output?

GET TABLES ON CARDS

Exports of goods
Exports of services ([illegible])
import content of
both the above

CBI Survey
latest figs

=

(19) ?

Michalski Report

Who there?
NOT M'fgs/Services

ATP - match or mirage?
example of latter

Industrial policy —
US?
Germany?

Alvey Japan

See Prospect

GET FIGS FOR
ROAD BUILDING,
SEWERS,

'Burden' of
Weinstock,
Hanson/Jones
(get [illegible] figs)

NB [illegible]

Specific mark 'services'

CH/EXCHEQUER

REC.	09 MAY 1985
ACTION	MR BATTISHILL
COPIES TO	CST, FST, MST, EST
	SIR P. MIDDLETON
	SIR T. BURNS
	MR KITTLER
	MR P. SEDGWICK

MR MOUNTFIELD
MR AARONSON
MR REDLEY
MR CROPPER
MR H. DAVIES
MR CULPIN

✓ 9/5

HOUSE OF LORDS

COMMITTEE OFFICE
HOUSE OF LORDS
LONDON SW1A OPW
01-219 ~~3218/3346/6075~~ 6412

8th May, 1985

Dear Mrs Lomax,

Get figs for oil & gas trade

SELECT COMMITTEE ON OVERSEAS TRADE

I am writing to give you some indication of arrangements for the meeting of the Committee on 15th May at which the Chancellor will be giving evidence.

The meeting will be held in Committee Room 4 and the Chancellor will be called at 10.30 a.m.

I understand that your Office has obtained from us copies of the oral evidence heard to date and you will no doubt have a fairly clear idea of the kind of questions that may be put. The Committee will try to cover the ground as follows:-

(i) The need for an industrial policy.
(ii) The priority accorded to manufacturing in the formulation of Treasury policy.
(iii) The effect of a decline in oil production in view of the size of the deficit in the balance of trade in manufactures.
(iv) The method and reliability of the mechanism by which trade in manufactures may be expected to recover automatically in the wake of declining oil production and export.
(v) The slowness of recovery in Britian's relative competitiveness.
(vi) The scope for services and invisibles as substitutes for manufacturing and manufactured exports.
(vii) The case for stability in the exchange rate of sterling.
(viii) The need for more and better direction of investment and R & D.
(ix) Government support for export finance and especially for capital projects.

You may like to know that next week's proceedings are to be recorded on film by both BBC and ITN for their respective news programmes as part of the Lords experiment in televising. This will be the third occasion on which our proceedings will have been televised and the presence of cameras is, on the whole, not obtrusive but the lights can make the room a little warmer than usual.

If there is any matter in which I can be of further assistance please let me know.

Yours sincerely,

Rhodri Walters.

R. H. WALTERS
Clerk to the Select Committee

Mrs. R. Lomax.

[Diff is that ~~[illegible]~~ I don't disagree — they do.] [To disagree on [illegible] & to disagree against]

FROM: H J DAVIES
DATE: 9 MAY 1985

PS/[illegible]

CHANCELLOR

Balance [illegible] better – no exports. DISCUSS

C/ You might care to discuss with Howard in transit. I've mentioned your motives to him.
[illegible] 9/5

cc Sir P Middleton
Sir T Burns
Mr Littler
Mr Battishill
Mr Sedgwick
Mr Mountfield
Mr Aaronson
Mr Redley
Mr Cropper

HOUSE OF LORDS SELECT COMMITTEE ON OVERSEAS TRADE

X Mr Wynn Owen's minute of 7 May asked me to prepare a list of the members of the committee with their industrial and commercial interests. The members are as follows:

Chairman: Lord Aldington (Conservative)

Chairman of Sun Alliance and London Insurance, Chairman of Westland Aircraft, Deputy Chairman of GEC, Director of Lloyds Bank. Formerly Chairman of Grindlays Bank and of the Port of London Authority. Also formerly a Director of Citicorp (until 1983).

Lord Beswick (Labour)

No current directorships noted. Chairman of British Aerospace 1976-1980 and Chairman of Airbus supervisory board 1978-1980.

Lord Boardman (Conservative)

Chairman of National Westminster Bank. Director of MEPC.

Lord Ezra (Liberal)

Chairman of Associated Heat Services. Chairman of Petrolex.

Industrial Adviser to Morgan Grenfell. Director of Solva S.A. Redland, and Royal Boskalis Westminster (a bankrupt Dutch group with dredging and other interests). Member of the Advisory Board of Petrofina. At the National Coal Board from 1956 to 1982.

Viscount Falkland (Social Democrat)

No industrial or commercial interests identified.

Lord Hatch of Lusby (Labour)

No industrial or commercial interests recorded.

Lord Kearton (Independent)

No current directorships recorded. Former Chairman of BNOC 1976-1979, member of UKAEA, and the CEGB. Director of Hill Samuel 1970-1981. Chairman of BPC 1981. Earlier career in ICI and Courtaulds ending as Chairman 1964-1975.

Lord Greenhill of Harrow (Independent)

Director of S G Warburg, Clerical, Medical and General Assurance, and The Wellcome Foundation. Director of BAT Industries 1974-1983. And Hawker Siddeley and Leyland International from 1977 to 1982. Deputy Chairman of BUPA. Director of BP 1973-1978.

Lord Selsdon (Conservative)

EEC Adviser, Midland Bank Group since 1979. Chairman of the Committee for Middle East Trade since 1979. Member of British Overseas Trade Board since 1983.

Lord Stoddart of Swindon (Labour)

No current industrial or commercial interests recorded. Formerly a telephones trainee and a clerical worker in a power station.

Lord Holworth (Conservative)

Director of the Bank of Scotland, of Halliburton (Oil Services), of the Sun Alliance Company of Canada. Former Chairman of General Accident, and formerly a Director of ICI.

HJD

H J DAVIES

PS/CHANCELLOR

From: T A H TYLER
Date: 9 May 1985

cc PS/Chief Secretary
Sir P Middleton
Mr Bailey
Mr Unwin
Mr Anson
Mr Burgner
Mr Judd
Mr Kitcatt
Mr Lovell
Mr Sedgwick
Mr G White
Mr Bradley
Mr Aaronson
Mr R Jones - o/r
Mr Peet
Mr Pratt
Mr K Murphy
Mr Sly
Mr Cropper
Mr Lord

C. Committee need really to receive ppr by tomorrow evening. Conclusions and annexes redrafted to meet your points. OK?

R 9/5.

OK

HOUSE OF LORDS SELECT COMMITTEE ON OVERSEAS TRADE: TREASURY PAPER ON PUBLIC PURCHASING POLICY

Your minute of 7 May recorded the Chancellor's comments on the draft Treasury paper on public purchasing policy, submitted with Mr Jones' minute of 25 April.

2. We have redrafted the conclusions to give a more positive emphasis to the benefits for industry of public purchasing policy. The proposed revised paragraph 18 is attached. In order to demonstrate what is said about the balance of trade in pharmaceuticals, railway equipment and mining machinery in paragraph 16 and the Conclusion, Annex B of the paper has been amended, as attached, to include additional relevant figures for these products and for manufacturing industry as a whole.

3. As regards the degree of penetration of public sector purchasing as between nationalised industries and central government, there is a need for some caution in interpreting the statistics in Annex A, as the definition of what constitutes an overseas purchase has not always been interpreted in the same way across the public sector. Within central Government, an improved definition, based on where the major element of value has been added, has been in operation since October 1984.

4. On further consideration, the breakdown of central Government purchasing in Annex A(a) to the level of major spending Departments other than MOD does not appear to add anything to the presentation, and so has been omitted. A revised Annex A is attached.

5. You will wish to bear in mind that the final version of the paper needs to go to the Committee by tomorrow evening, 10 May, at the latest.

TAHT

T A H TYLER

CONCLUSION

18. It is difficult to draw any firm conclusions from the overseas share in public purchasing, but the figures indicate that import penetration for the public sector is considerably lower than it is in the UK market for manufactured goods as a whole. Within the area of non-competitive defence contracts and contracts covered by the PPRS the arrangements for remunerating Government suppliers are fair and have provided them with a good level of profitability. In three particular areas where public sector purchasing is important (pharmaceuticals, railway equipment and mining machinery) the trade balance is substantially in surplus. The Government's public purchasing policy is designed to improve the competitiveness of its suppliers while continuing to obtain value for money for the taxpayer. The public sector still obtains the great bulk of its requirements from UK suppliers. UK suppliers can thus expect to benefit from the public sector's enlightened purchasing practices outlined in paragraph 5 above. This is a policy which is making an important contribution towards helping UK suppliers sell in other markets both in the UK and abroad.

Annex A - Overseas Share of Public Sector Purchasing

(a) Central Government - Contracts let for Goods and Services

	Overseas share				
	1979	1980	1981	1982	1983
				per cent	
Total - excluding MOD	6.6	8.8	10.7	12.5	13.3
Total - including MOD	7.2	8.7	3.8	4.0	7.9

Source: Government Purchasing Statistics

(b) Nationalised Industries - Purchases of Capital Goods and General Supplies

	Overseas share 1981 or 1981/82 (latest available)
	Per cent
Electricity Supply	2.2
BT	4.2
NCB	2.1
British Gas	3.4
British Steel	4.0
British Rail	2.8
British Shipbuilders	8.7
12 Other Corporations	3.3
Total	3.5

Source: Nationalised Industry Chairman's Group

Annex B - Overseas Share in UK Markets for Manufactured Goods and Balance of Trade

a) Overseas share in UK Markets for Manufactured Goods

Per Cent

	1979	1980	1981	1982	1983
Total manufacturing	27.2	26.5	27.8	29.2	31.1
Pharmaceutical products	18.5	17.0	19.3	20.7	22.6
Railway Locomotives, Wagons and Coaches	1.4	1.3	3.9	2.6	5.2
Mining machinery	2.1	2.6	1.8	2.3	3.0

b) Balance of Trade

£m

	1979	1980	1981	1982	1983
Total manufacturing	-3277	-256	-790	-3513	-9652
Pharmaceutical products	+392	+517	+548	+595	+592
Railway Locomotives, Wagons and Coaches	+50	+50	+68	+64	+33
Mining machinery	+70	+68	+46	+58	+41

Strictly comparable figures are not available for the generality of defence equipment. But on the basis of estimates derived from the statement on the Defence Estimates 1984 (Cmnd 9227 - II), the overseas share in 1983 was 3.3%; and the balance of trade for identifiable equipment in 1983 was £712m.

Sources: Business Monitors, British Rail, National Coal Board, British Steel Corporation, Industrial Economic Indicators Database.

33/1764

HoL Select Committee bfg mtg folder (+ draft Tsy paper on oil)

FROM: **P N SEDGWICK**
DATE: **10 MAY 1985**

Ch/
To be aware.. Advice has gone to the Sec of State over the weekend, & I'm promised a reply on Monday. X is clearly right (though how different the DEn note is I'm not in a position to judge)
RL 10/5

CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Littler
Mr Battishill
Mr Mountfield
Mr Culpin
Mr Mowl
Mr Aaronson
Mr Redley
Mr Cropper
Mr H Davies

Str comments. Also, what abt gas trends?

THE NOTE ON FUTURE NORTH SEA OIL PRODUCTION AND THE LIKELY BALANCE OF TRADE IN OIL FOR THE HOUSE OF LORDS COMMITTEE ON OVERSEAS TRADE

We encountered an unexpected problem connected with the note for the House of Lords Committee on oil production and the oil trade balance which you have approved and which was to have gone to the Committee today.

2. The Committee had apparently made an identical request for a note on production and the oil balance to the Department of Energy. Department of Energy officials did not tell us of this even though we cleared our draft note with them at each stage. We found out during the course of today, however, that they were proposing to advise their Secretary of State to put in a separate note to the Committee that expressed slightly different views from those in the Treasury note. In particular they wanted to make clear that it was possible that the UK might become a net importer of oil as early as the mid-1990's.

X 3. We argued strongly that there ought to be one note and that this ought to reach the Committee before your appearance. Department of Energy officials have therefore agreed to recommend to Mr Walker

(a) that a single note should go to the Committee on Monday of next week; this should either be a joint note or the Department of Energy would tell the House of Lords

Committee that they have nothing to add to the Treasury note;

and (b) that the text of the note should be as in the Treasury version except that the penultimate sentence of paragraph 6 of the Treasury note should be redrafted to read

> "Looking further ahead, the UK is likely to remain broadly self-sufficient in oil until the mid to late 1990's and could remain self-sufficient until well into the next century."

I think that we should accept this redraft which does not materially alter the argument from the original note.

P.N.S

P N SEDGWICK

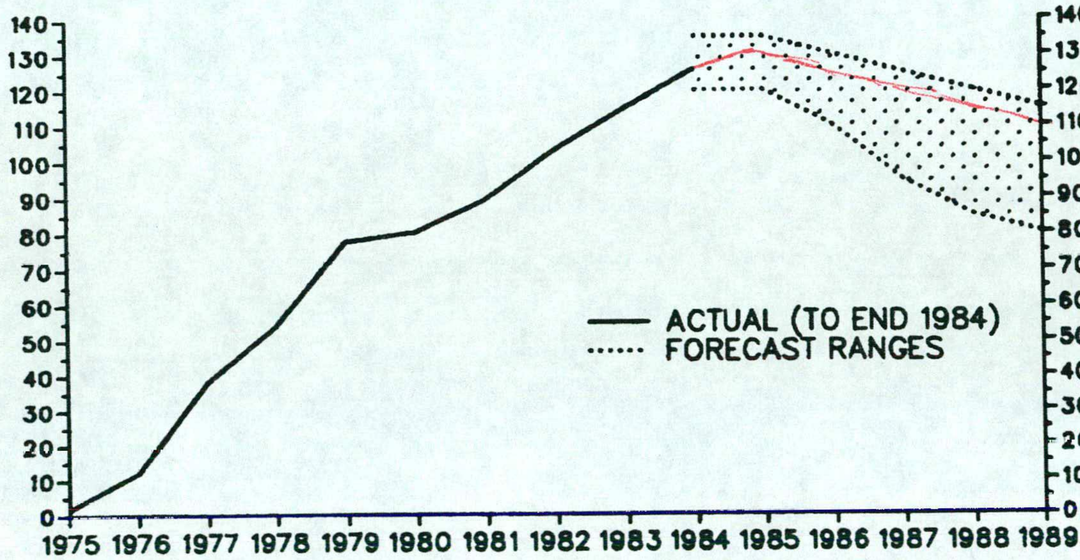
PROSPECTS FOR NORTH SEA OIL PRODUCTION AND THE BALANCE OF TRADE IN OIL

Memorandum by HM Treasury

Prospects for Production

North Sea oil and Natural Gas Liquids (NGL) production reached 126 million tonnes in 1984, the highest level to date. Chart 1 below illustrates the build up of North Sea production and the latest Government forecasts covering the period to 1989, announced by the Minister of State for Energy on March 13 of this year. These and past forecasts are reproduced in Table 1. The forecasts are in the form of ranges to make allowance for the considerable technological and geological uncertainties which influence the rate of production from both mature and recently discovered fields. Although production may be at or near its peak this year, the decline in production is likely to be gradual and slower than the preceding increase.

Chart 1 North Sea Oil and NGL production - million tonnes



? later yrs (estimates)

2. Production at around the centre of the ranges is the most likely outcome though, as Table 1 illustrates, since 1982, production has turned out towards the top of the range expected at the beginning of the year. This has mainly reflected higher than expected production in some large mature fields. In the preceding period of a rapid build up in North Sea production however, there was a persistent tendency for production to turn out lower than projected.

TABLE 1 **Oil Production Forecasts ***

million tonnes

Forecasts made in:	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
1976	15-20	35-45	55-70	75-95	95-115									
1977		40-45	60-70	80-95	90-110	100-120								
1978			55-65	80-95	90-110	100-120	105-125							
1979				70-80	85-105	95-115	115-140	115-140						
1980					80- 85	85-105	90-120	95-130	95-135					
1981						80- 95	85-110	85-115	90-120					
1982							90-105	90-115	95-125	95-130				
1983								95-115	95-125	95-125	85-120			
1984									110-130	110-130	100-125	85-115	80-115	
1985										120-135	110-130	95-125	85-120	80-115
Outturn	12.2	38.3	54.0	77.9	80.5	89.4	103.2	114.7	125.9	130	125	120	115	

*Including natural gas liquids and onshore production.

3. The uncertainties are obviously great and increase the further one goes in to the future. However there are grounds for cautious optimism. Experience in other parts of the world suggests that oil provinces turn out to contain more recoverable oil than is first thought, partly because more reserves are discovered and partly because techniques of recovery improve. Table 2 presents estimates of initial recoverable reserves made each year since 1980. These include an allowance for undiscovered reserves based on a statistical assessment of the likely number and size of future discoveries. Between 1980 and 1983, estimates of reserves did not change much from a range of 2000-4000 million tonnes. In 1984 however there was a substantial upward revision to the top end of the range which has not been altered much this year.

TABLE 2 **Initially recoverable reserves**

Estimate made in:	Million tonnes
1980	2200 - 4400
1981	2175 - 4350
1982	2100 - 4300
1983	2000 - 4200
1984	1980 - 5850
1985	1830 - 5475

The Oil Trade Balance

4. The path of the balance of trade in oil will depend on the path of domestic oil production relative to consumption, together with sterling oil prices. The latter depend in turn on the dollar oil price and the sterling/dollar exchange rate.

5. Table 3 illustrates the build up in the oil balance since 1975. The UK went from producing virtually no oil in 1975 to self-sufficiency by the end of 1980 - a matter of only five years. By 1983, three years later, the level of production was almost 60 per cent higher than the level of consumption. This mainly reflected the rapid build up in production, though since 1980 the surplus has also been boosted by falling domestic oil consumption. In 1984 the oil trade balance was about the same as in 1983, with the increase in oil production and sterling oil prices being offset by increased domestic oil consumption because of the coal strike.

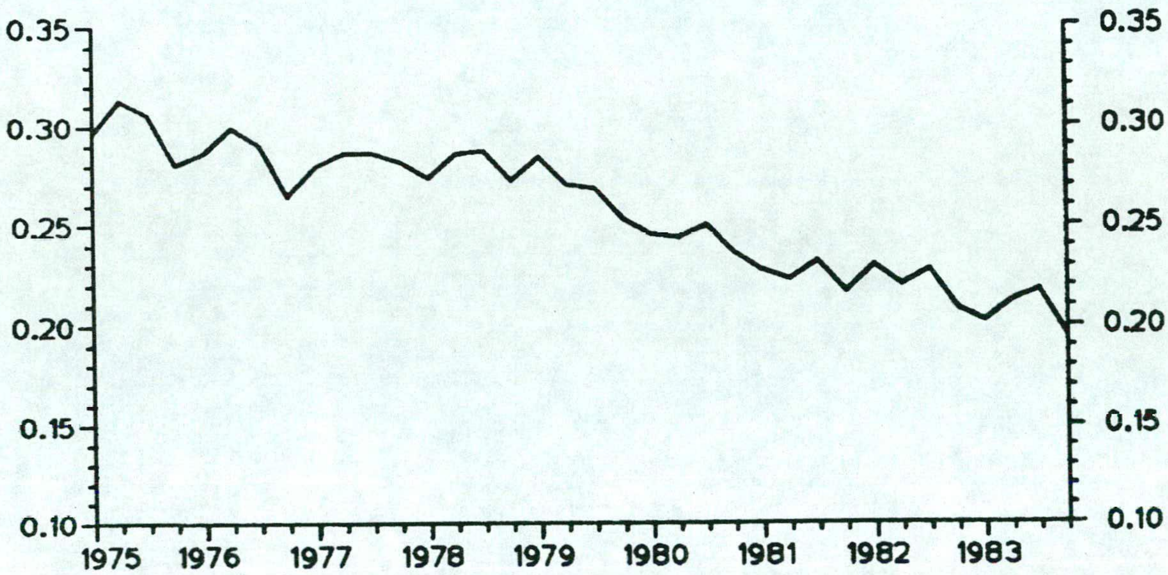
TABLE 3 **Oil Trade**

	Oil Production	Oil Consumption	Oil trade balance
	Million tonnes		£ billion
1975	1	97	- 3.1
1976	12	92	- 3.9
1977	38	95	- 2.8
1978	54	95	- 2.0
1979	78	95	- 0.7
1980	81	81	0.3
1981	90	75	3.1
1982	103	77	4.6
1983	115	72	6.8
1984	126	90	7.1

How much due to coal strike?

6. An increase in the oil trade surplus to £10 billion is forecast for this year, reflecting a fall in consumption after the end of the coal strike and a small increase in oil production. With oil production at or near its peak and with high sterling oil prices, the trade surplus in oil may be at its maximum in 1985. Over the period to 1989, the oil balance should however remain in healthy surplus given a limited decline in oil production and continuing downward pressure on consumption growth. Oil consumption has been falling in recent years and there has also been a marked decline in oil consumption relative to GDP as Chart 2 illustrates. This has mainly reflected greater efficiency in the use of oil in response to high real oil prices. Looking further ahead, it seems likely that the UK will remain self-sufficient in oil at least until the late 1990s. For example the latest forecast by the UK Offshore Operators Association (UKOOA) expects the UK to remain self-sufficient to the end of the century.

Chart 2 **Domestic Oil Consumption relative to GDP** [1]



1 Oil consumption measured in million tonnes of coal equivalent

b/f 14/5 for folder ~~prst~~ ~~& pt~~

FROM: I R Cunningham TOA
DATE: 13 May 1985

MR WYNN-OWEN

cc Mr Pegler (Ch/Secy)
Mr K Murphy
Mr Bradley

HOUSE OF LORDS SELECT COMMITTEE ON OVERSEAS TRADE: TREASURY PAPER ON PUBLIC PURCHASING AND OVERSEAS TRADE

1. We spoke about this late on Friday, 10 May, when you told me that the Chancellor had not reacted to Mr Bradley's submission of 3 May proposing an amendment to the draft Treasury paper. Mr Pegler indicated that the Chief Secretary had expressed no view before forwarding the paper (along with the others on this subject) to the Chancellor.

2. As both the Chancellor and the Chief Secretary were unavailable and the final version of the paper had to be with the Clerk to the Committee by close of play on Friday 10 May, we agreed that we should assume Ministerial agreement, and incorporate the amendment in the paper.

3. This I have done, and the paper has now gone to the Clerk to the Committee as attached. The annexes remain as attached to my manuscript minute of 10 May.

Ian R. Cunningham

I R CUNNINGHAM
233 8105

33/1764

FROM: P N SEDGWICK
DATE: 13 MAY 1985

CHANCELLOR

cc Sir T Burns
Mr Littler
Mr Monck
Mr Unwin
Mr Battishill
Mr Burgner
Mr Mountfield
Mr Kelly
Mr Culpin
Mr Folger
Mr Mowl
Mr Aaronson
Mr H Davies

Ch.

(1) Content with revised note on oil production for Committee.

(2) You wanted to work on the opening statement yourself. RL. 13/5

I have [illegible]. N

HOUSE OF LORDS COMMITTEE ON OVERSEAS TRADE

I attach

A A revised draft for your opening statement

This has been reordered in the way you requested and is shorter than the earlier draft.

B A revised note for the Committee on output and the balance of trade in oil and gas (prepared by EA2)

It has been agreed with the Department of Energy both that this should go to the Committee as a joint note from the two departments (in response to identifical requests), and that it should cover production & trade in gas as well as oil. The note summarises the available information that has been made public on gas. It does not have a run of figures of the balance of trade in gas (or oil) for future years, but makes clear that net imports of gas are expected to decline.

If you agree we could get this note to the Committee in the course of tomorrow morning. I think that we should try to do so.

P.N.S

P N SEDGWICK

19/1764

BRIEF 1

OPENING STATEMENT TO HOUSE OF LORDS COMMITTEE ON OVERSEAS TRADE

I welcome this opportunity for an exchange of views on trade in manufactures, and indeed trade in general. This is a complex area. ~~Some facts are well known, but other developments are not so widely appreciated. Perhaps I could~~ It might be helpful if I begin by briefly setting out what seem to me to be the key ~~ones:~~ facts.

PSE let me have supporting figs on c/a

First, though our trade in manufactures did not go into deficit until 1983, the surplus had been declining in real terms for at least 20 years. This long-term trend was ~~accompanied by~~ the counterpart of a reduction in our traditional deficits on agriculture and raw materials and an increase in our surplus on services. Since 1980 we have ~~of course~~ also had a growing surplus on oil, and a current account surplus overall.

Second the trend change in the balance of trade in manufactures is not the only or the most important development, The share of manufacturing in both GDP and employment has also been falling over a long period. Similar falls have occurred, mutatis mutandis, in all major industrial countries. In the UK manufacturing output fell from 32 per cent of GDP in 1960 to 21 per cent in 1983. The fall for the US was from 29 per cent to 21 per cent, and for Germany from 40 per cent to 32 per cent.

Move back

~~The same pattern is visible for employment, with the share of manufacturing in total employment having fallen in all the developed economies in the last fifteen years and with the current level being lower than in 1960 in most, with a few notable exceptions such as Japan.~~ ~~The share of manufacturing in output has declined a little~~ One reason why the decline has been slightly faster in the UK than in some other developed economies ~~, one well publicised reason being~~ is the emergence of the North Sea as a major oil producing area. Other energy producers such as Norway and the Netherlands have had a similar experience.

again, support figs on a cons. pse (nothing doing for these)

INSERT "A" HERE

Third, the swing from surplus to deficit on manufactured trade did not occur during the severe contraction in manufacturing output from 1979 to 1981, but during the subsequent recovery phase of the cycle. ~~It is not~~ Since the first quarter of 1981 there has been a ~~strong~~ growth in manufacturing exports of nearly 20 per cent ~~and this~~ which has contributed to growth in total manufacturing output of 10 per cent, roughly in line with growth in the rest of the economy. This ~~strong~~ vigorous recovery has led to a marked and ~~most~~ welcome rise in investment

as a result of a sharp growth in manufacturing exports there has been no breakdown on the export side. Indeed, which has risen significantly in each of the last three years and is now at a record level. The upturn in investment is on turn an important factor behind the high growth in imports of manufactured goods.

It is clear, therefore, that ~~The lesson that I draw from these facts is that~~ the trade deficit in manufactures cannot be taken as ~~is not a good~~ an indicator of the health of our manufacturing sector. I recognise that there is, nevertheless, concern in some quarters about what is going to happen as North Sea oil output declines. On that ~~Nevertheless I recognise that there is an anxiety that if manufactured trade were to remain in deficit the UK would later find itself with too few exports to pay for its imports, as oil production starts to decline. This anxiety is not well-founded.~~ would make three points.

NP) First, the surplus on trade in fuel will diminish only at a gradual rate as oil production declines slowly - with the UK possibly self-sufficient in oil to the end of this century and beyond - and with the balance of trade in gas likely to improve as gas imports decline.

NP) Second, the balance on non-fuel trade (including in particular ~~manufactured~~ trade in manufactures,) will ~~at the same time~~ tend to improve, in part responding to a fall in the — and I emphasise real — exchange rate, some of which has already occurred. The most important development that would sustain and strengthen this process would be a further deceleration in domestic unit labour costs. ~~This will occur if the recent higher growth in manufacturing productivity is sustained and if wage settlements decelerate further.~~

NP) Third the overseas assets we ~~are~~ have been building up while North Sea production is high will give us a return in the form of a permanent inflow of interest and dividend payments. In a sense this is a return to the historical pattern of the UK's trade accounts; ~~where we enjoyed~~ for many years before the second world war a substantial return from our overseas assets ~~which~~ financed a deficit on trade in goods.

NP

Fourth, it is ~~quite~~ possible that we ~~could~~ might see a continuation of the trend ~~whereby~~ in which the non-manufacturing private sector plays a gradually increasing role in our economy. This part of the economy - often rather misleadingly called "services", but comprising a wide range of activities such as construction, insurance, banking, ~~etc.~~ and so on - has been earning a substantial part of the foreign exchange needed to purchase our imports for many years. Last year our exports of "services" were worth £21~~BN~~ billion. The City of London alone earned a net £5½~~BN~~ billion in 1983.* Within "services" certain sectors have grown at very high rates. For instance, over the past ten years, exports ~~of civil aviation services have grown at an annual rate of 4 per cent in real terms over the last 10 years, and exports~~ in real terms of banking services have grown at an annual rate of ~~at~~ 7½ per cent.

8ut /

/NP

I fail to understand the argument that a £ earned by providing a service is not as valuable as a £ earned by producing a manufactured good. Nor do our service industries all depend for their markets on our own manufacturing sector. Some services, like tourism, are barely related to manufacturing.

* Gross figures for the City's earnings are not available.

In saying this I certainly do not imply that I foresee manufacturing withering away in this country with all our resources moving into services. Let there be no doubt that the Government wishes to see a healthy, flourishing and competitive manufacturing sector. It is, and will remain, an important ~~a key~~ source of output and jobs ~~in this country~~ and the more competitive it is the better off we shall all be. ~~But as our surplus on fuel trade gradually falls, the opportunities for all private non-North Sea businesses will increase, including manufacturing.~~ But there is no adamantine law that says we have to produce as much in the way of manufactures as we consume. If it turns out that we are relatively more efficient at providing services than at producing goods, then our national interest lies in a surplus on services and a deficit on goods. ~~Whether the manufacturing sector will be relatively less efficient in the future will of course depend on manufacturing industry itself. That is why the deficit in manufactured trade does not call for [more] specific Government financial help. But the government will intensify its efforts~~

The Government's job is to create ~~the right~~ an economic framework ~~by freeing markets and remove distortions in order to raise~~ best calculated to

improve

the competitiveness of all industries, ~~including~~ manufacturing, and services alike.