

• PO-CH/NL/725

PART A

SECRET
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Begins: 13/9/84
Ends: 15/10/84.

PO/CTH/NL/725
Part. A

Chancellor's (Lawson) Papers:
Autumn Statement 1984

C
N.B. especially
a) Assumption on coal strike
(Annex to 1st paper)
b) latest PSBR assessment (para 25 of second paper) *HP*

CONFIDENTIAL

FROM: HUW EVANS

13 September 1984

CHANCELLOR

- | | |
|---------------------|----------------|
| cc Chief Secretary | Mr Battishill |
| Financial Secretary | Mr Burgner |
| Economic Secretary | Mr Lankester |
| Minister of State | Mr Monger |
| Sir P Middleton | Mr Odling-Smee |
| Mr Bailey | Mr Sedgwick |
| Sir T Burns | Mr Scholar |
| Mr Littler | Mr Watson |
| Mr Anson | Mr Mowl |
| Mr Cassell | Miss Peirson |
| Mr Kemp | Mr Shields |
| Mr Monck | Mr Ridley |
| | Mr Lord |
| | Mr Portillo |

HP *must we do*
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C
No, not
normally.
HP

RECENT DEVELOPMENTS AND AUTUMN FORECAST

I attach two papers. The first sets out for your approval the assumptions proposed for the internal autumn forecast, now under way. The second, which is more by way of background, sets out recent developments in relation to our June forecast.

2. On the policy assumptions paper, which has been discussed in PCC, you will wish to note in particular:

- (i) our proposed treatment of public expenditure; and
- (ii) the assumptions relating to industrial disputes.

3. The second, monitoring, paper shows that the growth in activity this year looks slightly weaker, and the rise in unemployment a little faster, than we anticipated in June. The continuation of the miners' dispute has worsened the prospects this year for the balance of payments and the PSBR. But inflation remains low, with only the rise in the mortgage rate bumping up the RPI for a time.

HPE

H P EVANS

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POLICY ASSUMPTIONS FOR THE AUTUMN FORECAST

The internal autumn forecast, the final report on which we shall circulate before the middle of October, is intended to help in particular with the approach to the October/November discussions of public expenditure in Cabinet. The Autumn Statement, expected to be published in mid-November, will include a revised and updated economic forecast for 1985; public expenditure plans and fiscal/revenue projections to 1985-86 or extended to 1987-88. The internal forecast will cover the whole period of the Public Expenditure Survey, though reporting is likely to concentrate on the early years. If it is decided to publish revenue projections for the full three years, they will be based on stylised assumptions about growth and inflation, assuming a successful adherence to targets, as in the MTF5 - rather than on the more cyclical path in the forecast.

2. We propose in the forecast to stick wherever possible to the same policy assumptions as were used in the Budget and June forecast. In the case of public expenditure this needs to be spelt out in detail so that the forecast can be compared with, and then amended by, the decisions that will be taken this autumn.

3. We assume that the dock strike will soon be over, with only very minor effects on trade. On the miners' dispute, assumptions will be needed about the precise timing of the ending of the strike and about the consequentials. (See annex, not copied to all, for details).

Fiscal Policy

4. For 1984-85, the forecast will assume current tax rates and allowances. Together with the judgments about public expenditure, receipts from asset sales, judgments about revenue etc this will leave the PSBR in 1984-85 to emerge, unconstrained, from the forecasts.

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5. For the later years, the 1984 MTF5 assumed a path for the PSBR (assuming full revalorisation of all the main taxes and allowances) as follows:

	1985-86	1986-87	1987-88	1988-89
PSBR (£ billion)	7	7	7	7
(percentage of GDP)	(2)	(2)	(1 ³ / ₄)	(1 ³ / ₄)

6. It is proposed to make the same assumption about revalorisation and to stick to the same PSBR path, in percentage terms. The size, and sign, of the fiscal adjustment will depend, of course, on the assessment of tax revenues, spending plans etc. As in the MTF5, any necessary fiscal adjustment will be assumed to fall on personal income tax.

Monetary Policy

7. For 1984-85 and later years we propose to assume that interest rates are set so as to bring about the declining trends in monetary growth specified in the MTF5, while taking account of other relevant factors, especially the exchange rate.

8. With separate targets for M0 and £M3, it should be possible to construct the forecast on the assumption that M0 and £M3 each stay within their MTF5 ranges. The report will also display forecasts for other monetary aggregates, including PSL2, M1 and M2.

9. The effects of interest rates on narrow and broad aggregates are rather different. Raising short rates will reduce M0, but even the sign of the effect on £M3 is not certain. In the forecast we propose to vary short-term interest rates in a way that takes account of the relevant factors and especially of the need to keep monetary growth within the MTF5 ranges. In addition, funding policy can also be varied to some degree in order to keep £M3 within (though not necessarily at the centre of) its MTF5 ranges. We propose to assume achievement of a target for National Savings net inflow of £3 billion a year.

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10. The exchange rate is, as usual, assumed to float freely. This is consistent with some intervention by the authorities for short-term smoothing but no net purchases or sales of foreign exchange over time.

Public Expenditure

11. For 1984-85 and the following three years of the Survey, 1985-86 to 1987-88, the forecast will reassess the likely outturn for public expenditure, taking account of likely Cabinet decisions this autumn.

12. In order to forecast the outturn for 1984-85 and for the later years, we need guidance on a number of detailed points, listed in paragraph 16 below. But the main issues concern the assumptions about the outcome of this year's Survey, and the strain on the reserve.

13. We propose to assume that the irresistible bids identified by GEP are accepted. As for the cuts, we propose to assume that Cabinet will agree cuts in programmes of about £2 billion in 1986-87 and over £3 billion in 1987-88. These will be sufficient to achieve the planning totals endorsed by Cabinet on the assumption that the reserve is adequate (see table overleaf).

14. 1985-86 is more difficult. There is some reluctance at this point in the Survey to assume that the Cabinet's target will not be achieved. On the other hand our aim must be to produce a realistic forecast. We suggest that the starting point for the forecast should be the assumption of cuts in programmes in 1985-86 of some £1½ billion. This would enable the 1985-86 target for the planning total to be met only if a much smaller reserve of £2.3 billion were to prove sufficient. The forecast of outturn will as usual reflect not only the assumed increases and cuts, but also our central judgment of likely long-falls and short-falls on individual programmes.

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PUBLIC EXPENDITURE PLANNING TOTAL 1985-86 TO 1987-88

	£ billion		
	<u>1985-86</u>	<u>1986-87</u>	<u>1987-88</u>
1. Planning total in 1984 PEWP (adjusted for NIS reduction) and PSBR	131.7	136.3	-
2. Planning total endorsed in Cabinet in July	131.7	136.3	140.4
3. of which Reserve	3.8	4.8	4.9
4. "Irresistible" bids identified by GE	2.9	2.9	4.6
5. Offsetting cuts in programmes: GEP view of possible outcome	-1.4	-2.1	-3.3
6. Size of reserve, assuming planning total in row 2, and bids and cuts as in rows 4 and 5	2.3	4.0	5.0
7. Forecast of planning total in June forecast, taking account of likely over- and under-spending	133.1	139.4	-

15. The table above shows how the bids and possible cuts combine with the targets for the planning total to produce a reserve in row 6. This has to include an allowance of £³/₄-1 billion a year for unforeseen contingencies, as well as to cover overspending by local authorities, etc. Recent assessments, including the June forecast, suggest that the reserve of £³/₄ billion for 1984-85 will be overspent, and that a reserve of £2.3 billion for 1985-86 would also be likely to be overspent, perhaps by a substantial margin. But such judgments are of course uncertain and depend on decisions yet to be taken.

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16. Other points on public expenditure:

- (i) The impact on the plans of higher inflation or changes in other economic assumptions. For 1985-86 we propose to assume that cash-limited plans (as adjusted for bids, cuts and any allocations from the Reserve, etc) will hold. In the later years we would follow the usual convention of assuming that cash plans hold, subject to a maximum squeeze on central government cash limits of 2 per cent (including defence, to which the NATO commitment will not apply after 1985-86). In all years we would allow demand-led items to vary with the forecast.
- (ii) The assumed pattern of EC refunds and abatements, and the date of increase in the VAT ceiling. We propose to assume that the 1983 refund is received in 1984-85 and the 1984 abatement in 1985-86; and that thereafter abatements are received evenly throughout the year following that in which they arise. This would mean, for example, that our 1985 abatement will be received in equal instalments during the course of 1986. We assume some supplementary financing in 1984 and 1985, with the VAT ceiling raised in stages from 1 per cent to 1.4 per cent by 1 January 1986.
- (iii) Local authority rate-capping etc. We propose to assume no new legislation, but that current legislation is carried through (eg abolition of GLC etc). We shall need to make judgments as necessary about the likely effect of legislation and other measures to restrain both current and capital expenditure. We propose to assume that measures to keep capital spending close to cash limits in 1985-86 onwards will be introduced as necessary.
- (iv) Asset sales. For the current year, 1984-85, we shall consult PE later in the forecasting round. For all later years, we propose to continue with the assumption of annual sales of £2 billion.

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(v) Earnings. We suggest that our starting assumption for the 1984-85 pay round and later years should be as in the June forecast: that nationalised industry earnings rise at the same rate as private sector earnings, with public service earnings rising a little more slowly, at least in the first year or two.

17. National Insurance contributions. We propose to assume that, as in the FSBR, contribution rates are held constant for both employees and employers (the contribution rates from April 1985 must be decided this autumn). In addition we propose to assume that the Exchequer supplement to the Fund will be held at 11 per cent throughout the forecast period, and that the earnings threshold will be uprated in line with prices with the ceiling computed at 7.35 times the threshold (as in 1984-85) but rounded down to the nearest £5. As usual we propose to assume that benefits are uprated each November in line with price increases to the previous May. Given these assumptions and the economic environment emerging from the forecast, the fund surplus (or deficit) will be determined freely and will contribute to the fiscal adjustment. The likely outcome in 1985-86 on these assumptions is a large surplus, of the order of £1 billion.

EA & PSF

11 September, 1984

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ANNEX TO PAPER ON POLICY ASSUMPTIONS: THE MINERS' DISPUTE

It is proposed to make the assumptions that

(i) the strike is over by the end of December, without any increase in its effects on other industries;

(ii) electricity prices rise in April, as usual, and without recouping the extra costs of the dispute; and

(iii) coal stocks at power stations are partially rebuilt in the course of 1985, partly from stocks at pitheads.

2. These assumptions will not be made explicit in the internal forecast report, but will be implicit in the numbers. The assumptions proposed for the date on which the strike ends and for electricity prices are best regarded as no more than ones of convenience.

3. If the strike is still continuing when the Autumn Statement is being prepared, assumptions suitable for use in public will obviously have to be looked at again, but the same assumption on the date might well be convenient.

4. These assumptions are also being used in the three-monthly assessments of money and the PSBR.

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MONITORING THE FORECAST

The last Treasury Economic Forecast (TEF) was completed in mid-June. In the intervening three months, several events have occurred not anticipated in the TEF:

- (i) The continuation of the miners' strike and two dock strikes;
- (ii) some downward pressure on the UK exchange rate, partly associated with developments in the US;
- (iii) a rise in UK three-month interbank rates from $9\frac{1}{2}$ per cent to 12 per cent and back to below 11 per cent; increases in mortgage interest rates averaging $2\frac{1}{2}$ per cent;
- (iv) slightly weaker activity and rather higher unemployment.

2. The implications of these events will be considered in detail during the current economic forecast. This note provides an interim assessment of recent indicators and surveys the prospects for the rest of this calendar year.

Economic Activity

3. The June TEF looked to a growth in GDP of nearly 3 per cent in 1984 despite an assumed reduction in activity due to the miners' strike worth about $\frac{1}{2}$ per cent. Allowing for a strong contribution from North Sea Oil production, this implied a continuation in "underlying onshore" activity at a rate of just over $2\frac{1}{2}$ per cent per annum, marginally above that of 1983.

4. Recent data on activity have not been particularly encouraging, but they do not necessarily imply any marked softening in underlying growth. Complete information is not yet available on the components of expenditure for the second quarter, but preliminary data on the output measure of GDP indicated a small underlying rise. Manufacturing output, on provisional CSO estimates, appears

little changed since Q4 84; there is some contrast with the somewhat more buoyant CBI survey results. As expected, retail sales have bounced back from their low first-quarter level but without showing any renewed strength; car registrations have been below expectations.

5. The composition of final expenditure is still showing some encouraging trends. Manufacturing investment in the first half of 1984 seems to have been about 15 per cent above the trough a year earlier and underlying non-oil export volumes have maintained the high level achieved at the end of last year. Of some surprise has been the resumption of destocking this year (after taking account of the probable effect of the miners' dispute on energy stocks). The modest rebuilding of stocks in the second half of the year foreseen in the TEF now looks rather less likely.

6. Outside commentators have been fairly relaxed about underlying activity this year, despite higher domestic interest rates. The consensus of outside forecasts of GDP(0) growth for 1984 is still nearly 2¹/₂ per cent, after incorporating the effects of the miners' strike. Only the CBI and NIESR are projecting growth (on the output measure) as low as 2 per cent. Nevertheless, the indirect effects of the miners' dispute on other industries' demand and on confidence, together with the usual worries over latest data, make for an uncertain reading of recent activity movements.

7. The underlying cyclical position of the economy has attracted more attention, inspired mainly by the drop in the CSO's longer leading indicator between March and July this year. This has generally been interpreted by the Press as indicative of some slowdown in growth in the next year or so. Although short-term movements in the indicators must be viewed with caution (and can be much affected by specific factors such as the miners' strike) the June TEF showed a similar picture. It suggested that the underlying rate of growth this cycle would probably be highest in 1984 with some very limited tailing-off in 1985 and 1986. Under normal CSO methodology such a picture would probably indicate a "peak" of the cycle some time in 1985 or 1986.

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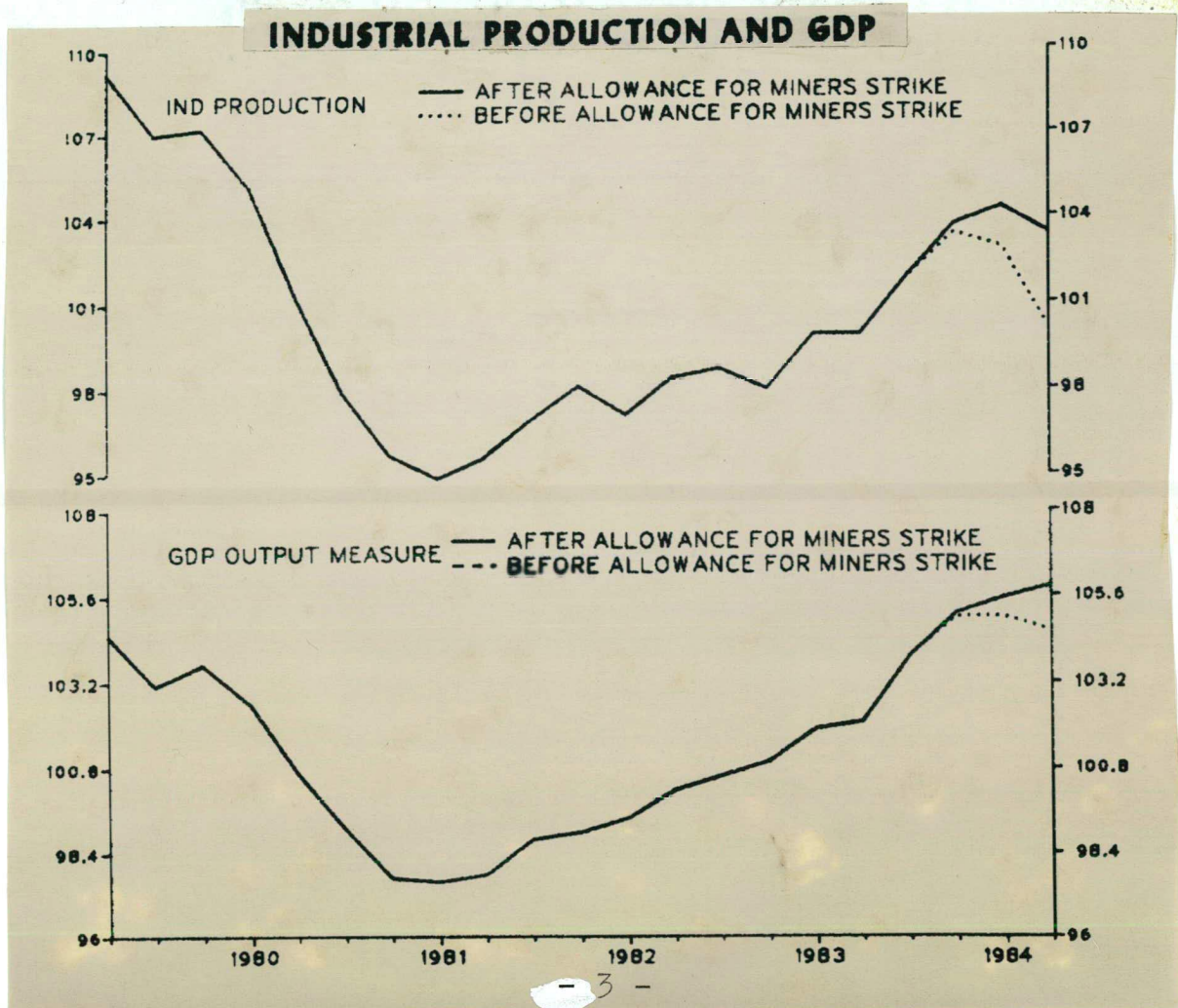
8. Analysis of cyclical developments in the recent past has been hampered by large discrepancies between the different measures of GDP. Revisions to be published in the 1984 Blue Book (13 September) will however bring them closer together, in part because of incorporation within the previously slower-moving output measure of allowances for additional productivity growth.

REVISED MEASURES OF GDP GROWTH

(percentage change on a year earlier)

	<u>GDP(O)</u>	<u>GDP(E)</u>	<u>GDP(I)</u>	<u>"Average" GDP</u>
1979	3.1	1.9	2.5	2.5
1980	- 3.0	- 1.8	- 2.3	- 2.3
1981	- 1.7	- 0.9	- 1.2	- 1.3
1982	2.0	1.4	2.9	2.1
1983 (earlier CSO estimates in brackets)	2.9(2.5)	3.4(3.4)	3.4(3.4)	3.2(3.7)

9. The output measure is now more representative of movements in "average" GDP and indicates well the strength of the current upturn, although growth in the industrial component has been less marked.



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Labour Markets

10. Adult unemployment rose by an average of 11 thousand a month in the six months to August, similar to the underlying rate of growth (after allowing for the effects of special employment measures) in the second half of 1983. There is thus no sign yet of the sustained slowdown envisaged in the June forecast.

UNEMPLOYMENT (EXCLUDING SCHOOL LEAVERS)

Average monthly change (Thousands)

Adjusted (approximately) for Budget
Measures and SEMS

1983	1	+ 28
	2	+ 31
	3	+ 11
	4	+ 14
1984	1	+ 24
	2	+ 11
April		+ 5
May		+ 16
June		+ 13
July		+ 18
August		+ 17

11. The rise over the last year in the underlying level of claimant unemployment has occurred despite a sharp upturn in employment - the employed labour force rose 265 thousand in the year to March 1984. This is almost certainly partly accounted for by a resumption of growth in the labour supply over the past year. Department of Employment projections published in February suggested growth of perhaps 150-200 thousand between mid 1983 and mid 1984, mainly because of a higher population of working age. But in addition it seems clear that many of the new jobs have gone to people who were not previously claiming unemployment benefit. The number of part-time jobs done by women rose by 200,000 in that period, very few of whom would have been on the register.

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12. Recent developments in the manufacturing sector have been generally in line with our expectations at the time of the June forecast. Average weekly hours appear to have levelled out since 1983 Q4, with overtime per operative close to the previous peak. Manufacturing employment was flat in the three months to May and rose 4000 in June. With manufacturing output relatively flat since the beginning of the year, the anticipated cyclical slowdown in productivity growth is now occurring - growth in output per head in the year to Q2 was only 4 per cent compared with 8 per cent between 1982 H2 and 1983 H2. Here again, uncertainty over measurements means that provisional figures may overstate the change.

Inflation

13. Recent movements in the RPI have continued to be slightly better than expected with the fall in the 12-month rate to 4.5 per cent in July being attributable to prices generally being relatively stable or falling. In spite of a sizable fall, seasonal food prices were still above normal in July but have shown a further substantial fall since then. The 12-month increase in the half of the RPI index representing prices other than for Nationalised Industries, food and housing (it includes the increases in indirect taxes in the Budget) has been running at 4 per cent for some months and dropped to $3\frac{3}{4}$ per cent in July. At the producer (output) price level, the rate of increase outside the food, drink and tobacco components has been steady at about $5\frac{1}{2}$ per cent p.a for the past two years.

14. Prospects for the RPI in the next few months have deteriorated, mainly as a consequence of the increases in mortgage interest rates which add up to $3\frac{3}{4}$ per cent to the August index. Overall cost pressures have also increased with a lower exchange rate and apparently slower rates of productivity growth. Nevertheless, it seems unlikely that the 12-monthly increase in the RPI will rise much above 5 per cent this year.

15. Outside forecasts have, once again, been persistently more pessimistic this year than the Budget projection for end-1984. As the year progressed, however these forecasts showed signs of converging on the Treasury projection of $4\frac{1}{2}$ per cent - until the fall in sterling and rise in mortgage interest rates pushed them back up again. The consensus forecast is now for $5\frac{1}{2}$ per cent, which still looks too high.

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16. Little has changed on the pay front, except that the teachers' arbitration award and attitudes on the non-industrial Civil Service settlement look set to confirm the June assessment that the 1983-84 pay round will turn out very similar to that for 1982-83: whole economy settlements averaging around 5¹/₂ per cent and underlying earnings increasing by about 7¹/₂ per cent.

Balance of Payments

17. The latest (but still very provisional) data from the CSO on the current account show the surplus for the first half of 1984 as £0.6 billion lower than the June forecast at only £0.2 billion - although we would not be surprised if the CSO revised upwards again their figures for invisibles. The published FSBR forecast for the full year was £2 billion, reduced to £1-£1¹/₂ bn in the June TEF.

18. Developments in non-oil export and import volumes continue to be broadly as foreseen in the FSBR, with the level of non-oil exports, which rose rapidly in the fourth quarter of 1984, showing little change since then, and the underlying rate of growth of non-oil import volumes slackening to around 4 per cent per annum. With the recent fall in sterling feeding through into trade prices fairly quickly, import prices in the last three months are 9¹/₂ per cent higher than a year ago, and export prices 8 per cent higher.

19. In the event, the July dock strike had little impact on the balance of trade in July, although non-oil export and import volumes were both 6-7 per cent below trend. The impact of the present strike (if short) could be even smaller, since only about a third of non-fuel seaborne trade is handled by the strike-bound ports, leaving traders considerable scope to divert cargoes.

20. The oil balance continues to be depressed by the miners' strike, which now seems to be causing additional net imports of fuel of £200-250m a month. This implies that the total cost of the miners' dispute to the current account so far this year is in the region of £1 billion [Not for use]. This is rather higher than allowed for in the June forecast.

21. Overall, the prospects remain for a modest surplus on the current account this year, although the margins of error on these forecasts remain large. The transfers balance will improve when we receive our refunds from the EC in respect of our 1983 overpayment.

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Financial Developments

22. Dollar interest rates have developed much as expected since the June TEF, with three month Eurodollars averaging around 12 per cent, but the sharp rise in domestic interest rates in early July was not anticipated. Although, as seemed likely at the time, much of the increase was temporary, with rates falling back subsequently, three month interbank rate has averaged $10\frac{3}{4}$ per cent in recent weeks, one point above the level envisaged in the forecast.

23. There appear to have been a number of factors, both external and domestic, underlying the rise in interest rates. The pound weakened as a result of stronger than expected US growth and the associated fears of higher US interest rates, weak dollar oil prices and UK industrial disputes. Sterling is currently below the June TEF, some 2 per cent in effective terms and 7 per cent against the dollar. Domestically, there were poorer than expected June money figures and continuing market worries about bank lending, PSL2 and the PSBR. Subsequent money figures have eased market worries somewhat. Growth of both M0 and £M3 in the target period to banking August, $4\frac{1}{2}$ per cent and 9 per cent respectively, is within the target range.

Public Sector

24. The June forecast suggested that the PSBR in 1984-85 might be £1 billion lower than the FSBR forecast of $\pounds 7\frac{1}{4}$ billion, mainly because of expected higher tax revenue from North Sea Oil and additional asset sales.

25. Recent developments suggest that the outturn could end up much closer to the FSBR forecast, for three main reasons. First, expenditure is likely to turn out higher, principally because of the prolongation of the miners' strike and recent higher interest rates (affecting particularly ECGD's costs) Second, on current trends the local authority borrowing requirement seems likely to be above the FSBR forecast, reflecting unexpectedly high borrowing in April (late expenditure in March) and the capital overspend. Third, non-North Sea taxes are running a little lower than forecast in June, though they could recover. However, the PSBR is subject to many different influences and the considered autumn forecast could produce a rather different picture.

26. Outside comment (except from NIESR) is at present generally favourable, expecting the PSBR to be held to the FSBR forecast.

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Peretz



MR EVANS

FROM: D L C PERETZ
14 September 1984

cc	Chief Secretary	Mr Battishill
	Financial Secretary	Mr Burgner
	Economic Secretary	Mr Lankester
	Minister of State	Mr Monger
	Sir P Middleton	Mr Odling-Smee
	Mr Bailey	Mr Sedgwick
	Sir T Burns	Mr Scholar
	Mr Littler	Mr Watson
	Mr Anson	Mr Mowl
	Mr Cassell	Miss Peirson
	Mr Kemp	Mr Shields
	Mr Monck	Mr Ridley
		Mr Lord
		Mr Portillo

RECENT DEVELOPMENTS AND AUTUMN FORECAST

The Chancellor was grateful for the two papers attached to your minute of 13 September. He is content with ~~the~~ proposed assumptions for the internal Autumn Forecast.

DLCP

D L C PERETZ

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From
Sir Terence Beckett CBE
Director-General

b/f 9/10/84
12/10/84

CBI

BY HAND

28th September, 1984

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1P 3AG

EXCH	
REC.	28 SEP 1984
ACTION	MR BATTISHILL
COPIES TO	CST, FST, MST, EST MR LORD, MR RIDLEY MR PORTILLO MR FOLGER MR MAKEHAM

M. W. Wake -
Mun's
Ads
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EB

Dear Chancellor

Autumn Statement

Our Council discussed the Autumn Statement at its meeting on 19 September and I am sending you a memorandum setting out its agreed views. The Council strongly endorsed the need to reduce the level of taxation and for tax revenues to determine the level of public spending that could be afforded and not vice versa.

Against that background, the Council stressed the importance of reducing public spending and urged that continued efforts be made to bring down current spending on the basis proposed by Malcolm McAlpine's Working Party. You will already have received the second Report of this Working Party on public expenditure, "Efficiency in the Public Services". It is suggested that savings could build up over four years to £6 billion per annum. Industry attaches the greatest importance to making savings in current spending of the kind suggested in the Report. This will help provide greater scope for tax cuts, which will do much to improve the "supply side" of the economy.

Members were also concerned that there should be room for a significant increase in capital spending on the nation's infrastructure, as suggested in the CBI's recent report "The Fabric of the Nation".

1/11/84
L. W. Wake
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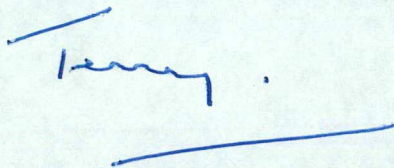
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CW

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We see all these measures helping to improve industry's competitive position. In this context, it is essential that there should not be increases in the burden of National Insurance Contributions this year and we propose that a review of the tax and National Insurance Contribution system be carried out.

The economy is undoubtedly looking up and our aim in these Representations is to keep the recovery going without rekindling inflation. I intend to make our views known to the press later this week.

Yours sincerely



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CBI REPRESENTATIONS FOR THE 1984 AUTUMN STATEMENT

Introduction

- 1 In our Representations for this year's Budget we stressed the importance of sustaining growth. We pointed out that a medium term programme for improving competitiveness and encouraging enterprise was crucial for this.
- 2 In his Budget, the Chancellor accepted many of our recommendations to help sustain growth. This paper sets out the next steps in our medium term programme, containing our representations for the Autumn Statement.
- 3 We mainly confine ourselves at this stage to representations on the two topics, public expenditure and National Insurance Contributions, where decisions are typically announced in the Autumn. The economic prospects and the scope for Budgetary action will be clearer in the New Year, when the decisions are made on taxation.

The Economic Background

- 4 Strikes both in this country and abroad have masked some of the underlying trends in the economy. This difficulty is exacerbated by the discrepancies between the pictures presented by our own Surveys and the official statistics. The CBI Survey data points to greater increases in activity in manufacturing than the official data. In the past when official statistics have given a different impression from our own Surveys, later data or revisions to the past data have shown our Surveys to be giving the more accurate picture of the underlying trends¹. As usual our interpretation of the economic situation is, therefore, heavily influenced by our Survey information, and is reflected in our forecasts for future prospects.

1 See "Twenty five Years of Ups and Downs", edited by D F McWilliams, CBI 1983.

- 5 The forecasts suggest that although growth this year will be depressed by the strikes, the average measure of GDP is still predicted to rise by 2.5%. On the assumption that the miners' strike is over by the end of this year, there will be some catching up in 1985. For this reason, growth next year could be nearer 3% (even though we believe the underlying trend could be less upward than in 1983). By the second half of 1985, GDP could have risen by about 10% from the bottom of the recession in 1981 to a level 7% above that of 1979, with manufacturing output up 7½%, but still nearly 10% below its 1979 level.
- 6 Our forecasts suggest that real profitability, which for a long time has been very depressed by both historical and international standards, is making good progress in recovering towards internationally comparable levels. We believe that this will be a key influence on medium term prospects.
- 7 Meanwhile, our Surveys also show that the underlying inflation trend is still favourable. Although RPI inflation has been distorted upwards (in relation to the trend) by rises in mortgage rates, by the delayed effects of last year's rise in import prices and by the need to raise profit margins, the Surveys point to an historically very small proportion of manufacturing firms expecting to raise domestic selling prices.
- 8 The improvement in profitability and in the economic climate is leading, this year, to the largest annual increase in real business investment, 11%, since the war. Nevertheless, companies are expecting to run a record financial surplus this year. We believe that a sustained recovery, aided by lower interest rates, will generate the confidence necessary for continued increases in investment.
- 9 The two weak spots in UK economic performance remain unemployment and competitiveness. These are interrelated. Improved competitiveness would ensure that a higher proportion of demand both at home and abroad was met by UK production, which in turn would improve the prospects for employment in the UK. The UK is continuing to lose its share of world trade: unit labour costs in the UK are still significantly higher, relative to those in competitor countries, than on average in the 1950s and 1960s. Until this is reversed, or offset by improved non-price competitiveness, the UK trading position is likely to remain unsatisfactory.
- 10 Our assessment, then, is that the underlying trends in the economy are relatively healthy and that profitability is improving towards internationally competitive levels. As a result we believe that the decisions on public expenditure and National Insurance Contributions taken this autumn should concentrate on dealing with the more deep seated problems of the economy, particularly those affecting employment and competitiveness.

Our Main Representations

- 11 We have set out our main representations on public expenditure earlier this summer in a 'Memorandum to the Chief Secretary', and two publications, "The Fabric of the Nation"² and "Efficiency in the Public Services"³. This paper therefore only sets out our main recommendations.

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Centre Point
103 New Oxford Street
London WC1A 1DU
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Telex 21332



Economic Directorate

27 September 1984

With the compliments of Charles Burton.

Please note the embargo.

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Centre Point
103 New Oxford Street
London
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Telephone: 01-379 7400



P.165.84

EMBARGOED: NOT FOR
PUBLICATION BEFORE
0030 HOURS ON
FRIDAY, 28 SEPTEMBER

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From
Sir Terence Beckett CBE
Director-General

CBI

1 OCT 1984 29

PPS PL

BY HAND

28th September, 1984

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1P 3AG

DATE	23 SEP 1984
ACTION	MR BATTISHILL
COPIES TO	CST, EST, MST, EST MR LORD, MR RIDLEY MR PORTILLO MR FOLGER MR MAKEHAM

Sir P. Middleton, Sir T. Burns
Mr Bailey, Mr. Bitter
Mr A. Wilson, Mr Byatt
Mr Anson, Mr Unwin
Mr Cornell, Mr Kemp
Mr March, Mr Manger
Mr Evans, Mr Watson, Mr Schol
Mr P. R. C. Gray, Ms Seaman, Mr Pratt

Dear Chancellor

Autumn Statement

Our Council discussed the Autumn Statement at its meeting on 19 September and I am sending you a memorandum setting out its agreed views. The Council strongly endorsed the need to reduce the level of taxation and for tax revenues to determine the level of public spending that could be afforded and not vice versa.

Against that background, the Council stressed the importance of reducing public spending and urged that continued efforts be made to bring down current spending on the basis proposed by Malcolm McAlpine's Working Party. You will already have received the second Report of this Working Party on public expenditure, "Efficiency in the Public Services". It is suggested that savings could build up over four years to £6 billion per annum. Industry attaches the greatest importance to making savings in current spending of the kind suggested in the Report. This will help provide greater scope for tax cuts, which will do much to improve the "supply side" of the economy.

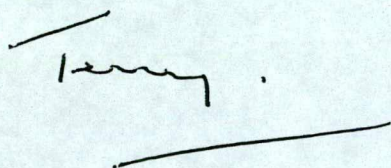
Members were also concerned that there should be room for a significant increase in capital spending on the nation's infrastructure, as suggested in the CBI's recent report "The Fabric of the Nation".

/...

We see all these measures helping to improve industry's competitive position. In this context, it is essential that there should not be increases in the burden of National Insurance Contributions this year and we propose that a review of the tax and National Insurance Contribution system be carried out.

The economy is undoubtedly looking up and our aim in these Representations is to keep the recovery going without rekindling inflation. I intend to make our views known to the press later this week.

Yours sincerely

A handwritten signature, possibly "Henry", is written in black ink. It is positioned between two horizontal lines that serve as a signature line. The signature is cursive and somewhat stylized.

Enc

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Facsimile 01-240 1578

Director-General
Sir Terence Beckett CBE

Secretary
Denis Jackson



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**NEWS
RELEASE**

CBI
CONFEDERATION OF
BRITISH INDUSTRY

P.165.84

EMBARGOED: NOT FOR
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FROM: A M ELLIS
DATE: 2 October 1984

PS/CHANCELLOR

*Note
Both parts already
agreed (at a meeting
EST did not attend)
DMP*

cc Chief Secretary
Financial Secretary
Minister of State
Sir P Middleton
Mr Battishill
PCC
Mr Burgner
Mr Evans
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Watson
Mr Folger
Mr Pratt
Mr Ridley
Mr Portillo
Mr Lord

TOWARDS THE AUTUMN STATEMENT

The Economic Secretary has read Mr Battishill's submission of 27 September.

In paragraph 4 of Annex A, on an alternative timetable in the event of slippage, merchant bankers have advised that if the Autumn Statement cannot be made before BT Impact Day then it should be delayed until after the start of dealing (3 Dec) as a Statement between the two dates would impede the flotation. The Economic Secretary has commented that, in his view, such a delay in the Statement would arouse serious suspicions about its content and could be even more disruptive.

Also, he is inclined to agree with the suggestion (paragraph 12) that, since unexpected bad news on public spending should not be released immediately prior to Impact Day, consideration ought to be given as to how the market could be prepared in advance for this.

AE

A M ELLIS

*Page**As I found v.*FROM: MISS M E PEIRSON
DATE: 3 October 1984

MR PERETZ

c
You have the earlier pps (with post-strike oil burn note) Phil

cc Chief Secretary	Mr Monck
Financial Secretary	Mr Battishill
Economic Secretary	Mr Evans
Minister of State	Mr Odling-Smee
Sir P Middleton	Mr Scholar
Mr Bailey	Miss Rutter
Sir T Burns	Mr Barnes
Mr Cassell	Mr Ridley
Mr Kemp	Ms Spencer

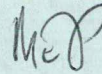
AUTUMN FORECAST: PRELIMINARY VIEW: LOCAL AUTHORITIES IN 1985-86

1. Your note of 1 October enquired (paragraph 2a) about the forecast of local authority current and capital spending in 1985-86.
2. The Budget forecast assumed £1¼ bn overspend (compared with the PEWP plans) on local authority relevant current expenditure, to be met from the reserve. It assumed no overspend on capital, because at that stage the overspend in 1983-84 was not known. It assumed £¼ bn overspend on non-relevant current expenditure (mainly housing subsidies and benefits), also to be met from the reserve.
3. The settlement decided by Ministers for local authority targets, affecting relevant current expenditure, adds around £1 bn to the PEWP plans, but is fairly tough. Although the present forecast assumes some overspend beyond the settlement, the total additional expenditure beyond the PEWP plans is not thought likely to exceed the Budget forecast of £1¼ bn overspend, at least not by any significant amount. This assumption takes into account the resulting growth in relevant current spending between 1984-85 and 1985-86 in cash terms, and the implied effects on manpower (where no more than a 1% reduction between the two years is thought plausible) and procurement (where a rather bigger volume reduction seems likely).
4. *N.B.* As for capital, the assumption is that Ministers agree to cut the PEWP plans for 1985-86 by the £0.4 bn of overspend in 1983-84. Therefore capital spending should be lower than the Budget forecast (which assumed no cut or overspend), even though the present forecast also assumes that the revised capital cash limits are not quite held (ie that there is some overspend).

CONFIDENTIAL

5. These two judgments resulted in my statement that "local authorities' spending (relevant current and capital) should be at or below the Budget forecast". It can be seen that this statement is not very firmly based: it depends on various judgments. Moreover, our final forecast next week may well be somewhat different.

6. My statement excluded non-relevant current expenditure, where - as indicated elsewhere in my note of 28 September - the present forecast is for an even higher overspend than assumed in the Budget forecast. The local authorities are now responsible for housing benefits, and as a consequence the rate of take-up of these benefits is increasing rapidly. Some allowance was made for this in the Budget forecast, but our latest judgment is that the overspend then predicted was not enough.



MISS M E PEIRSON

FROM: K F MURPHY
DATE: 4 October 1984

MR SCHOLAR

cc Mr Watson
Mr Monger
Mr Evans
Mr Pratt
Miss O'Mara

19

CBI REPRESENTATIONS ON THE AUTUMN STATEMENT

You will by now have seen a copy of Sir Terence Beckett's letter of 28 September to the Chancellor.

2. I attach a draft submission to the Chancellor, with a draft reply to Sir Terence. Miss O'Mara has told me that the Chancellor has commented "Let's have details" beside the assertion that savings of £6 billion over 4 years could be made from greater public service efficiency. I had assumed that the Chancellor wished to ask the CBI for more details in his reply, but I now notice from Sir Terence's letter that the Treasury appears to have received the document referred to. I infer, therefore, that the Chancellor would like to have a brief note on the contents of the McAlpine Working Party's report. Could I ask you to supply something?

3. Perhaps Mr Evans could let me have a passage for the submission if there are any points in the CBI forecast of the economy which he thinks are worth drawing to the Chancellor's attention. Similarly, could Messrs. Monger and Watson do likewise on the tax and social security issues referred to?

4. Since the CBI have not asked to see the Chancellor, and their representations have been released to the Press, I assume only a short non-committal reply is called for. I would welcome comments on the attached draft.

5. It would be desirable to let the Chancellor have this submission before he departs for the Conference. Could I possibly ask for contributions or comment by lunchtime on Monday 8 October, if at all possible?

K F Murphy
K F MURPHY

FROM: K F MURPHY

DATE:

1. MR BATTISHILL
2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
 Financial Secretary
 Economic Secretary
 Minister of State
 Sir P Middleton
 Sir T Burns
 Mr Bailey
 Mr Littler
 Mr A Wilson
 Mr Byatt
 Mr Anson
 Mr Unwin
 Mr Cassell
 Mr Kemp
 Mr Monck
 Mr Monger
 Mr Evans
 Mr Watson
 Mr Scholar
 Mr Folger
 Mr Gray
 MS Seammen
 Mr Pratt

CBI REPRESENTATIONS ON THE AUTUMN STATEMENT

Sir Terence Beckett wrote to you on 28 September, enclosing a memorandum of the CBI's views on the economy and their representations for the Autumn Statement.

2. The CBI's main representations were set out in their "Memorandum to the Chief Secretary", received in []. Their main recommendations are:

(a) that public expenditure should be set at a level which would permit the burden of taxation to be reduced from its 1983-84 level of 38½ per cent of GDP to 34½ per cent (the 1978-79 level) in 1989-90;

(b) an extra £1 billion a year to be spent on capital infrastructure projects;

(c) that savings building up to £6 billion a year over 4 years could be achieved by implementing the recommendations of the report of the McAlpine Working Party "Efficiency in the Public Services";

(d) there should be a review of the interaction of the tax and NICs systems, but that, pending any longer term move towards integration, there should be no increase this year in the real burden of NICs on employers or employees.

3. You asked for details about point (c) above. [GEP to provide].

4. Unlike last year, the CBI have not requested a meeting with you to discuss their representations. The document which they sent you has already been released to the Press. In these circumstances, a short non-committal reply to Sir Terence seems to be all that is required. I attach a draft.

K F MURPHY

DRAFT LETTER FROM THE CHANCELLOR OF THE EXCHEQUER

TO:

Sir Terence Beckett CBE
Director General
Confederation of British Industry
Centre Point
103 New Oxford Street
LONDON WC1A 1DU.

AUTUMN STATEMENT

Thank you for your letter of 28 September 1984.

2. I have read with interest your recommendations, [and the report of the McAlpine Working Party]. As you know, I strongly agree about the need to make further reductions in the burden of taxation, and the consequential need to keep public spending under control. I will, of course, bear your views in mind in preparation for this year's Autumn Statement.

[N.L.]

FROM: K F MURPHY
DATE: 9 October

1. **MR BATTISHILL** *MB*
9/10
2. **CHANCELLOR OF THE EXCHEQUER**

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Littler
Mr A Wilson
Mr Byatt
Mr Anson
Mr Unwin
Mr Cassell
Mr Kemp
Mr Monck
Mr Monger
Mr Evans
Mr Watson
Mr Scholar
Mr Folger
Mr Gray
MS Seammen
Mr Pratt
Mr Makeham
Mr Ridley
Mr Lord
Mr Portillo

c/
We've had it typed
ready.

MAN
10/10

CBI REPRESENTATIONS ON THE AUTUMN STATEMENT

Sir Terence Beckett wrote to you on 28 September, enclosing a memorandum of the CBI's views on the economy and their representations for the Autumn Statement.

2. The CBI's main recommendations are:

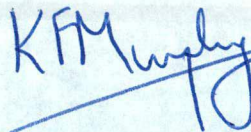
- (a) that public expenditure should be set at a level which would permit the burden of taxation to be reduced from its 1983-84 level of 38½ per cent of GDP to 34½ per cent (the 1978-79 level) in 1989-90;
- (b) an extra £1 billion a year to be spent on capital infrastructure projects;

(c) that savings building up to £6 billion a year over 4 years could be achieved by implementing the recommendations of the report of the McAlpine Working Party "Efficiency in the Public Services";

(d) there should be a review of the interaction of the tax and NICs systems, but that, pending any longer term move towards integration, there should be no increase this year in the real burden of NICs on employers or employees.

3. The CBI submitted a "memorandum on public expenditure" to the Chief Secretary in July, which discussed, inter alia, the conclusions of the McAlpine report (which was itself published on 3 July). The Chief Secretary met representatives of the CBI on 31 July (copy of meeting notice attached - top copy only). Many of the recommendations in the McAlpine report (which covers local authorities and the NHS, as well as the Civil Service) are in line with Government policy, in particular the emphasis on value for money and efficiency. The projected savings are attributed to manpower reductions (£4½ billion, concentrated especially in the local authorities), improved management of procurement (a 10 per cent saving of £2½ billion) and pensions (an increase in the effective contribution paid by public service employees other than civil servants, £½ billion.) The aggregate saving figure, which was admittedly very broad brush, was rounded to £6 billion. We doubt whether this forecast is reliable or useful. In particular, the CBI's calculations generate savings higher than the Government's estimates of financial savings from equivalent manpower reductions, because we do not believe that overheads decline in proportion to staff numbers, and because, where savings accrue from contracting out, only a small proportion (30 per cent or less) of the total costs are saved.

4. Unlike last year, the CBI have not requested a meeting specifically with you to discuss their representations. The document which they sent you has already been released to the Press but received relatively little comment (see attached press cuttings). In these circumstances, a short non-committal reply to Sir Terence seems to be all that is required. I attach a draft.

A handwritten signature in blue ink, appearing to read 'K F Murphy', with a long horizontal line extending from the end of the signature.

K F MURPHY

P. H. [unclear]

DRAFT LETTER FROM THE CHANCELLOR OF THE EXCHEQUER TO:

Sir Terence Beckett CBE
Director General
Confederation of British Industry
Centre Point
103 New Oxford Street
LONDON WC1A 1DU

AUTUMN STATEMENT

Thank you for your letter of 28 September and for ~~letting me have~~ ^{memorandum} the CBI Council's ^{sitting} views in advance of this year's Autumn Statement. ^{and}
^{you}

I read the Council's recommendations very carefully and you may be sure that I shall keep them in mind, ^{over the coming weeks.} As you know, ~~I strongly agree~~ ^{we are at one} on the need to make further reductions in the burden of taxation, and on the crucial importance of keeping public spending under control if we are to be able to bring taxes down to acceptable levels.

[N L]



1. T. Williams
2. T. McDonald s/r

PUBLIC EXPENDITURE: CBI REPORTS

NOTE OF A MEETING IN HM TREASURY ON 31 JULY

Present:

**Chief Secretary
Mr Bailey
Mr Gieve**

**Mr McAlpine (CBI)
Mr Caff
Mr McWilliams
Mr Morgan**

The Chief Secretary said that he had read the CBI's memorandum on Public Expenditure with great interest and had also studied the two Reports - "the fabric of the nation" and "efficiency in the Public Services". He asked whether there were any points in particular that the CBI wished to emphasise.

2. Mr McAlpine said that their Report, Efficiency in the Public Services, had taken as given the present level of service and had sought to estimate the efficiency gains that might be possible, taking account of the scale of improved efficiency achieved by the private sector over the last 5 years. They had been anxious not to exaggerate the gains that should be possible and their estimate of £6 billion had been calculated after allowing for a 20% deduction for contingencies. Since the bulk of public spending went on manpower, these savings could only be achieved by a reduction in employment of some 450,000. However the exercise was not intended to increase unemployment. Indeed, by reducing taxes and interest rates the savings should increase the strength of the economy. Moreover, where the reduction of public service manpower resulted from extra contracting out, there would be

an automatic increase in private sector employment. The savings the CBI had recommended would be just about enough to reduce taxation as a percentage of non-oil GEP to 34% in 1988 - the same percentage as it had been in 1978. This was not an outrageously ambitious target and it was most important that the Government should set a target for taxation in these terms and limits its expenditure accordingly.

3. Turning to the other report, Mr McAlpine said that, in view of the continuing concern among CBI members about the level of public capital spending, they had gone to their members and asked what projects they thought were desirable. In view of the range of projects and the limited time available, their report concentrated on roads. They had been well aware of the dangers of increasing public expenditure as a whole and had limited their proposal to expenditure of up to £1 billion a year. Some £300m would be necessary for the road projects identified in the Report as essential and a further £100m was necessary in the Water Industry. The remaining £600m would be available for such projects as could demonstrate a good return.

4. In further discussion, Mr McAlpine said that the CBI were well satisfied with the reduction in civil service numbers but they were concerned by the inability of the Government to influence the numbers employed by local authorities and the NHS. It was most concerned by the way in which the Government was blamed for savage cuts when in fact the services and manning had remained broadly unchanged. The DLO legislation provided a useful lever in that field and might be extended. It was not essential for ~~the work~~ actually to be contracted out; very often it was just as satisfactory for the existing authority workforce to sharpen their performance in the face of competition. The Chief Secretary thanked Mr McAlpine for his support in the Civil Service. He pointed out that steps were being taken in the NHS following the Griffiths Report to improve management generally and to increase contracting out in particular. The position on the local authorities was more difficult politically.

5. Mr McAlpine said he strongly approved the Financial Management Initiative especially the decentralisation of responsibility

and the introduction of incentives for particular managers. Mr Caff said it was vital to ensure that proper arrangements were made for reporting back on actual performance as compared with plan. It was also important that the management systems should be used in the PES exercise. Mr Bailey said that the Civil Service were just learning now some of the management techniques that were well known in the Private Sector. However there were special difficulties in quantifying objectives in the Public Service. The Chief Secretary said that any helpful comments that the CBI could offer on this front would be most welcome. Mr McAlpine said that he recognised that the improvement in efficiency would take a number of years and that pilot schemes would be necessary. He suggested that improved purchasing techniques were one area which should be examined.

6. Turning to the infrastructure, the Chief Secretary agreed with the CBI that each project had to be justified on its own merits. However, he had to bear in mind also the need to hold down the total of public expenditure and the PSBR and it was very difficult to get the necessary savings on current expenditure to finance an increase on the capital.

7. Mr McAlpine said that the CBI were proposing savings of around £6 billion a year and increases of only £1 billion. He suggested that off-balance sheet financing might be possible if the Treasury took a mildly broader view of ways of raising private sector finance for some capital projects. More generally, the CBI were most concerned by the apparently inexorable increase of public spending. In 1980 and 1981 the Government had been planning a reduction in expenditure. Not only had this not been achieved - so the base had been raised - but the Government had now apparently abandoned any hope of decreasing expenditure in real terms.

8. The Chief Secretary said that the possibility of using a private finance of infrastructure projects had been examined a number of times without success. There was therefore bound to be a tax/expenditure trade-off. That said, he was most grateful

for the CBI's contribution to identifying savings on current expenditure and their general support for the Government's commitment to restrain public expenditure as a whole.

9. It was agreed that the CBI would send officials in the Treasury in draft the article for CBI news that would report the meeting.

Tina Spencer

for - JOHN GIEVE

Distribution:

PPS
FST
MST
EST

Sir P Middleton

Mr Bailey

Mr Anson

Mr Scholar

Mr Ridley

Mr Lord

Mr Lovell

Miss M P Brown

Ms Conn

Mr P Gray *PLP*

CBI calls for five-year tax cutting programme

BY PHILIP STEPHENS

THE Confederation of British Industry yesterday urged the Government to give a firm commitment to progressively cutting taxation over the next five years.

In representations to Mr Nigel Lawson, the Chancellor, before the Government's autumn statement on public spending plans and the economic outlook, the CBI said that excessive taxation was discouraging investment and inhibiting growth.

It urged Mr Lawson to set public expenditure at a level which would reduce the tax burden (excluding North Sea income) from its 1983-84 level of 38½ per cent of gross domestic product to 34½ per cent by 1989-1990.

Sir Terence Beckett, the CBI director-general, said Mr Lawson should seek major savings in current public spending, rising to £6bn annually over four years.

That, combined with economic growth, would allow both tax cuts and increases in capital spending of £1bn a year.

Among the capital spending schemes suggested by the CBI is a £300m-a-year programme to improve Britain's roads.

It also wants the Government to review national insurance contributions, which, it says, damage competitiveness and employment.

In the meantime, there should be no real increases in national insurance contributions.

Daily Telegraph

CBI calls for 27 'pre-1979 tax'

CUTS IN State spending to finance a reduction in the tax burden to pre-1979 levels are urged on the Chancellor today by the Confederation of British Industry.

In representations ahead of the autumn statement on public spending, the CBI says excessive taxation is discouraging investment and initiative and inhibiting economic growth.

It wants the tax burden (excluding North Sea taxes) reduced from 38.5 p.c. of national output in 1983-84 to 34.5 p.c. by 1989-90, the same as in 1978-79.

CBI pushes for status quo

The Confederation of British Industry paints such a rosy picture of the British economy in its representations to the Chancellor before his autumn economic statement that Mr Nigel Lawson could be forgiven for preening himself.

Outcry, says the CBI, is better than the official figures show, with a forecast rise of 2.5 per cent this year, despite the coal strike, and nearer 3 per cent in 1985 if the strike is over by then. Real profitability is rising strongly towards the international norm; inflation trends are even better than shown by the retail price index; companies are expecting a record financial surplus despite the biggest real rise in investment since the war. So, says the CBI, this is not the time to rock the boat. Instead, budgetary policy should be aimed at increasing the competitiveness of British industry so that British firms can provide more jobs.

This is sound, encouraging stuff. When it comes to prescriptions however, the CBI betrays that its proposals have been drawn up by a committee.

Taxation is too high. The Government should aim to cut the general level of taxation back to 1978-79 levels by 1989-90. Public spending should be cut to fit that level of taxation. On the other hand, ministers should be looking for more short-term cuts in capital spending. Far from it. Indeed, they should be spending an extra £1 billion a year on cost-effective infrastructure projects, including an extra £300m a year on roads for each of the next 10 years.

This circle must be squared by cutting government's current spending by £6 billion a year over four years - a task which the CBI supposes has been taken care of for the benefit of Treasury ministers in its paper on "Efficiency in the Public Services". The need for such attempts to square the circle is, in case it be forgotten, a result of unemployment spoiling the Government's financial equations. If unemployment were lower, the need for such unconvincing reasoning would disappear.

The CBI may, therefore, be on stronger ground in its call for more direct aid to competitiveness. Autumn is the time when public spending and National Insurance contributions are dealt with rather than the budget as a whole.

National insurance contributions do increase the cost of labour directly and therefore presumably reduce demand. Any moves geared to cut labour costs must surely help that central policy problem and any measures that would increase labour costs should be resisted.



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

10 October 1984

Sir Terence Beckett CBE
Director General
Confederation of British Industry
Centre Point
103 New Oxford Street
LONDON WC1A 1DU

purp

Chief Secretary
Financial Secy
EST
MST
Sir P Middleton
Sir T Burns
Mr Bailey
Mr Littler
Mr A Wilson
Mr Byatt
Mr Anson
Mr Unwin
Mr Cassell
Mr Kemp
Mr Monck
Mr Evans
Mr Watson
Mr Scholar
Mr Folger
Mr Gray
Ms Seaman
Mr Pratt
Mr Makeham
Mr Ridley
Mr Lord
Mr Portillo
MR BATTISHILL
MR MURPHY

AUTUMN STATEMENT

Thank you for your letter of 28 September and for the memorandum setting out your Council's views in advance of this year's Autumn Statement.

I read the Council's recommendations very carefully and you may be sure that I shall keep them in mind over the coming weeks. As you know, we are at one on the need to make further reductions in the burden of taxation, and on the crucial importance of keeping public spending under control if we are to be able to bring taxes down to acceptable levels.

A handwritten signature in black ink, appearing to read 'Nigel Lawson'.

NIGEL LAWSON

CONFIDENTIAL

FROM: T BURNS
DATE: 10 October 1984

SIR PETER MIDDLETON

cc: Mr Bailey
Mr Battishill
Mr Evans
Mr Peretz (personal) —

DAVID

Mr Bailey asked
for a meeting for 2.30 pm on
Monday afternoon to consider the
forecast - we have pencilled it in.

P
lus.

FORECAST TIMETABLE

I have discussed the timetable with Mr Evans. We have agreed that he will submit the forecast and assumptions to the Chancellor by the week-end. Although this will not leave very long to examine the details for a Monday afternoon meeting it should provide the basis for decisions on the Star Chamber issues.

TB

T BURNS

CONFIDENTIAL*ump*
12/10/84SIR PETER MIDDLETON

c.c. Sir T. Burns
Mr. Battishill
Mr. Evans
Mr. Odling-Smee
Mr. Scholar
Mr. Shields
Mr. Peretz (personal) ✓

ECONOMIC FORECAST/ASSUMPTIONS: TIMETABLE

We mentioned this problem briefing at PCC yesterday. I have since seen a note from Mr. Evans (dated 8th October), proposing the following timetable:

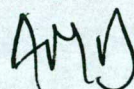
"October 12 and 15" Submission of economic forecast/assumption

Tuesday 16th October PCC

Wednesday am 17th October Meeting with Chancellor

Thursday 18th October Letters to departments/submission to Prime Minister/figures to Star Chamber

As you see, this uses up most of next week before we can set firm targets for Star Chamber. We cannot afford any delay at all on that front. I understand that Mr. Evans might be able to submit the forecast/assumptions on Friday, and we might be able to have a discussion with the Chancellor on Monday afternoon. This would pre-empt PCC discussion to some extent - and Sir T. Burns might prefer to have longer to produce his note on the forecast - but you are aware of the urgency. Do you agree we should ask everyone to work to the earlier timetable?



A. M. BAILEY

mp



C

We gather you still
have the draft minute
to the PM, regarding the
conclusions of yesterday's
meeting.

Amoy

16/10



Wason
Tony B
AS
BT off
(+5/2)

C

Sir PEM has asked for, & I have arranged, a small pre-meeting (of CST, PEM, TB, AB) at 11.45 before the full cast arrive at 12.00. The aim, I think, is to take your & CST's views about how much of a fudge we might be prepared to settle for on PES — & hence how likely we are to need 2 Cabinets..

Apart from that, you could do worse than go round the room — starting with PEM — asking for recommendations. (I gather Tony B was forbidden to make a recommendation!).

I think I wd go for deciding now to put BT off a week; & deciding between

us & the PM (but perhaps no wider than that yet) that the AS will also be a week later (thus avoiding the "Monday announcement" problems).

That wd leave us with a BT deadline (useful for PR reasons); and I am sure we could find convincing reasons now for pushing BT off a week that need not worry the markets.

RP

FROM: A M W BATTISHILL
DATE: 12 October 1984

- 1. SIR PETER MIDDLETON cc
Copy attached for Chief Secretary
- 2. CHANCELLOR OF THE EXCHEQUER

- Mr Bailey
- Mr Littler
- Sir T Burns
- Mr Anson
- Mr Cassell
- Mr Monck
- Mr Burgner
- Mr H P Evans
- Mr Monger
- Mr Odling-Smee
- Mr Scholar
- Mr Watson
- Mr Folger
- Mr Pratt
- Mr Ridley
- Mr Lord

*W.S. - 1st yr, despite C/S
Lester, W.S.
W.S. 17/11*

This results from discussions which I have had with Kleinworts and Mr Bailey with the Cabinet Office - and a lot of hard work by many others. We are convinced that there is no real fall back position - only a choice of extremely risk alternatives which must be made very quickly. We have made arrangements to discuss it with you on Monday. Could you and the Chief Secretary make this top priority reading for the weekend.

Sm 12/11a

TIMING OF AUTUMN STATEMENT

Following the discussion before the Party Conference we have considered urgently what would be involved in bringing forward your Oral Statement to Monday 12 November and divorcing it from the printed Autumn Statement which would then be published on Thursday 15 November, after the economic debate on Tuesday 13 November, the last day of the Queen's Speech Debate.

2. We have also received more advice from Kleinworts about the progress of arrangements for the BT sale. In the light of that we have taken another hard look at the Autumn timetable, and at the implications of any slippage in settling the public expenditure figures. The rest of the submission is, therefore, structured in three parts. It examines:

- A. the implications of the twostage operation for the Autumn Statement on 12 and 15 November;
- B. the possibility of advancing the printed Autumn Statement, as well as the Oral Statement, to Monday 12 November;
- C. the serious consequences of not settling public expenditure by 8 November.

The most pressing issues arise under this last heading.

A. A TWO-PART OPERATION

3. What follows presupposes - as have earlier submissions - that the 8 November Cabinet settles the public expenditure figures in sufficient detail to enable the Government's plans, at least for 1985-86 if not for all three years, to be announced immediately after the weekend.

4. With a two-part operation there are three main issues:

- (a) What is the minimum documentation needing to be issued alongside your Oral Statement, assuming the latter covers the usual ground;
- (b) In what form is that best produced; and
- (c) What are the other implications of proceeding in this way.

Documentation

5. Industry Act Forecast. It must be right to publish the Forecast alongside the Oral Statement. This provides the necessary economic framework for next year's spending plans. And it would help with your speech in the debate the following day. The text will have been completed and agreed with you well before Cabinet on 8 November, and there should be time for any last minute revisions in the light of the spending decisions.

6. Public Expenditure. In your Statement to the House last year you reaffirmed the planning total for 1984-85, listed the programmes that were being increased and those where savings were being made, and confirmed the Contingency Reserve at £3 billion. For the details of the coming year you referred people to the Autumn Statement and for later years, to the February White Paper. This year you will also want to say something about the current year's outlook for public spending.

7. Assuming the Oral Statement takes broadly the same form this year the least that will be required is to publish a version of Table 2.1 from the Autumn Statement, giving the Departmental breakdown of the planning total for 1985-86 - if not for the two later years. The arguments against publishing the later years' figures are that it may not be possible to produce them in the time, and that their absence would reinforce the impression of the Government producing what it could for the House against an exceptionally tight timetable. Whether to include three years' figures in the printed Statement could then be decided separately. We would also think it right to publish Table 2.3 showing the nationalised industry EFLs for 1985-86.

8. But it will almost certainly be necessary to go beyond just issuing the tables. This year in particular the figures are likely to require the most careful presentation. Some Spending Departments are certain to want to issue their own press notices on Departmental programmes, particularly where they have had to take cuts or settle for less than they wanted. The Departmental figures will need to be put into context, and it is difficult to see how we could do with much less than the brief descriptive text which normally accompanies the figures in the printed Statement. There may be some scope for selectivity - depending on how the decisions come out - and for even more rounding of the figures at this first stage (though commentators are bound to probe any differences or discrepancies between the press notice and the printed Statement. But, on the whole, we think it would be right to aim to publish a Treasury press notice which covers broadly the same ground and detail as Part 2 of the Autumn Statement.

9. However, we doubt whether it would be necessary to deal extensively with the manpower figures on the Monday, even if you wanted to mention the totals in your Statement to the House. The detailed figures could be kept back for the printed Statement on the Thursday (if by then, it was clear that we were including three years' expenditure figures) or given in a Parliamentary Answer on Thursday (if it was clear that we were not).

10. National Insurance Contributions. You will need to announce the results of the usual Autumn Review of contributions in the Oral Statement. Consequently, the GAD Report, which provides the detailed background to decisions, will also need to be laid at the same time (if necessary, in typescript form) to accompany the various national insurance Orders. Bearing in mind the Parliamentary row three years ago over the National Insurance Review, we think it would also be wise to publish Table 3.1 from the Autumn Statement showing the estimated contribution payments by employees and employers next year, together with a short description of the changes and the economic assumptions provided to the Government Actuary. This suggests a Treasury press notice on the lines of Part 3 of the Autumn Statement.

Mechanics

11. The maximum flexibility in preparing for a Monday Oral Statement lies in having three separate Treasury press notices dealing respectively with the forecast; the public expenditure figures; and the NIC Review. The first and third can be virtually drafted well in advance, subject only to checking after Cabinet on the 8th. We would plan to try to reproduce these after Ministerial approval during the course of Friday and Saturday, 9 and 10 November.

12. The public expenditure press notice is potentially more difficult, and will require the fullest co-operation from Spending Departments in clearing detailed programme figures and text, if possible by Friday night. In cases of difficulty or dispute we shall need to be able to consult Treasury and Departmental Ministers at the weekend, so that the press notice can be completed, and reproduced, at the latest during the course of Sunday, 10 November.

13. We must plan on the basis that up to some 3000 copies of each press notice will be required to meet the needs of both Houses, the press and Government Departments. This allows sufficient copies to be placed in the Vote Office for every Member of the Commons. Like the printed Autumn Statement in normal years, these would be made available at the end of your Oral Statement.

14. Perhaps about 40 Treasury staff will need be involved in working over the weekend and they will have to be warned as soon as possible if typists and photocopiers are to be available in sufficient number. As this is the weekend of Remembrance Sunday, contact with the Metropolitan Police will need to be made at an early stage to ensure access to the Treasury building.

*A big
point.*

15. The timetable will be extremely tight, especially for the public spending press notice; but it should be manageable provided Cabinet reaches clear-cut decisions, there are no serious disputes about interpretation and Departments cooperate in agreeing final figures and text.

Other implications

16. Compared with previous years, the time for preparing the Autumn Statement brief will also be much shorter. This too will need to be worked on through the weekend so that copies can be ready on Monday morning. There will be no opportunity, as there was last year, to produce a second draft for final comment and correction

17. We shall need to let you have a final draft of the Oral Statement by Friday night (when it will also need to go to the Prime Minister), so that you can look at it over the weekend. Similarly, you may also want to give some time over the weekend to your speech for the Economic Debate (which takes place on an Opposition amendment) on Tuesday 13 November.

*and opposition
agree
this?*

18. On this scenario, a separate debate on the Autumn Statement as such can be left until later. One possibility is to have this a week later - in the week beginning 19 November before business is taken up with the Second Readings of newly-introduced bills. But another, perhaps preferable, alternative would be to delay the Autumn Statement debate until after Christmas and then try to combine it with the debate on the Public Expenditure White Paper. Aside from the obvious attractions, this would make it much easier to handle the Treasury Committee who complained bitterly last year that they had no time to produce a report before the House

debated the Autumn Statement. Mr Higgins would be sure to complain again if there was a debate the following week.

19. This sequence of events should be acceptable for the BT timetable. Indeed, having the Oral Statement one day earlier would provide an extra day for the markets to come to terms with it. The only possible snag would be if the printed Statement contained public spending figures for the second and third year which were not disclosed in the Oral Statement - and if the markets did not like them. On the whole it would probably be safest to plan to provide three years figures on the Monday, or not at all - in which case the two later years would be left, as in the past, to come out in the White Paper after Christmas.

Summary

20. A number of things stand out from this brief analysis.

21. Almost three-quarters of the Autumn Statement would need to be published in advance on the Monday in the form of Treasury press notices, with only the tax ready-reckoner section omitted. Even though we would not be printing, this would still involve a major operation over the weekend following the 8 November Cabinet. Though there would be somewhat more flexibility than with a printed Statement, the deadlines would still be very tight. And if we are effectively publishing the Autumn Statement twice, we shall need a good story to explain why - to fend off reports of chaos, reversion to ad hoc arrangements, or panic to clear the decks for BT. To appear to respond to Opposition pressure (as the Chief Whip suggested) by advancing the Autumn Statement, might not help too much: the Government might still be criticised for not settling the public expenditure figures in time to publish the full Autumn Statement before the Economic Debate, since all the relevant events would be seen as within their control. Finally, with much of the key information released beforehand, there could also be some effect on sales of the printed Statement.

B. FULL PUBLICATION ON MONDAY 12 NOVEMBER

22. We have therefore considered again whether it would be possible to bring forward publication of the printed Statement even further and publish on Monday 12 November after your Oral Statement. In my submission of 27 September I said this might just be technically possible - at a cost - so long as any decisions on detail left over from the 8 November Cabinet could be settled quickly and the public expenditure figures and text cleared with Departments and with Ministers (including Treasury Ministers) by mid-morning on Saturday (or, at worst, with one or two final amendments possibly slipping into the afternoon). These deadlines would need to be met so that final typesetting could be completed on Saturday. After Saturday night there would be no further opportunity for changes. Printing would begin early on Sunday morning and continue throughout the rest of that day and through the night to provide sufficient copies for Parliament, Departments and HMSO bookshops in London on Monday afternoon. Sunday night printing has not been done before by the security printers and an overtime rate would have to be negotiated. This could be expensive.

23. It would be possible to build in some further margin, for example by delaying the start of printing, if absolutely necessary, until Sunday lunchtime. But this would probably mean that the Autumn Statement would not go on sale in HMSO bookshops (or not in sufficient number) until Tuesday.

24. This would be a high-risk operation, with little or no margin for contingencies of any kind over the weekend. But I would not want to say that the Autumn Statement could not be published on the Monday if that is what Ministers preferred - provided the Cabinet conclusions were relatively straightforward and the details were not disputed by spending Ministers, and provided our luck held over the weekend. But the printing could be fairly expensive and we would have no margin for error. If we went for Monday publication, it would be best to decide from the outset not to try to include three years' expenditure figures.

25. A decision to go for Monday publication, if that were the choice, would need to be confirmed immediately after Cabinet on the 8th. Provided people were warned in advance, it would not be too late then to stand down the printers and revert to a two-stage operation if that seemed wiser.

C. FALL-BACK POSITION

26. The whole of the foregoing assumes that the 8 November Cabinet settles this year's public expenditure round. If that does not happen, or if it appears before 8 November that a later Cabinet is going to be needed, the Autumn Statement will have to be deferred. The Economic Debate would then proceed on Tuesday 13 November without the public expenditure figures and the Autumn Forecast. But we would then run into problems over BT. As you know, Impact Day is planned for 16 November, three or four days after the Autumn Statement

27. If we were to conclude that there was a significant risk that Cabinet would not be able to reach final decisions by 8 November, there would, in effect, be 3 options. For reasons explained below, however, the first two options are already closing and need to be addressed next week. The options are:

- (a) to decide now to postpone the Autumn Statement by one week, and postpone BT Impact Day from 16 November to 23 November;
- (b) to leave BT Impact Day as 16 November but to postpone the Autumn Statement until early December;
- (c) to accept the risk that public expenditure and the Autumn Statement will slip, but nevertheless stick to the present plan and attempt to reach decisions by 8 November.

(a) Postpone Impact Day by a Week

28. The possibility of moving Impact Day by one week from 16 to 23 November has been discussed on a number of occasions with Kleinworts and DTI. Kleinworts' position has hardened during the course of these discussions - and particularly in the last few days. Except for genuine market reasons at the time, they are now much more strongly opposed to any postponement, although they acknowledge that they are not legally committed to a 16 November Impact Day. Their reasons are:

- ?? W. G. B. W.
- (a) Substantial numbers of people already believe Impact Day to be 16 November - in the City, among regional brokers and in the press. A postponement would imply that the sale had run into problems. Questions would be asked about the reasons for delay which would be difficult to answer except by reference to public expenditure discussions.
 - (b) There would be severe planning and logistical problems. In particular advertising schedules have been booked and targetted for the period up to 16 November. New slots would have to be negotiated (very difficult in the pre-Christmas period; and extremely expensive). The Treasury estimate of possible costs is £8-10 million.
 - (c) Lengthening the pathfinder period from three to four weeks would be most undesirable, whilst putting it back a week is now not possible. The BT roadshow is due to start immediately after the pathfinder prospectus is published, invitations have been issued and a number of key investing principals have been lined up to see it (whose diaries might not easily be rearranged).
 - (d) The marketing effort would be severely affected, in particular financial institutions have to make arrangements for funds to mature on the due date.

29. There are real difficulties here even allowing for some overstatement in Kleinwort's presentation. A postponement decision now would undoubtedly involve disruption; and in addition to the measurable cost in (b) above, there could be an unquantifiable risk to the price. What is clear is that the later a decision to postpone is taken the more potentially damaging are the consequences. The premium payable to secure advertising slots is likely to increase. More seriously, the later any postponement is made, the greater is the risk of disrupting the process of pricing and underwriting the BT sale during the pathfinder discussions between 26 October and 16 November, particularly if this was thought to be caused by difficulties in agreeing acceptable public expenditure figures. This could be very damaging to the BT price.

30. Kleinworts see a need (though it is not a legal one) to specify Impact Day in the Pathfinder Prospectus (published 26 October, but printing requirements mean that they need a firm date by 19/20 October). Their firm preference is to leave the date at 16 November and accept the continuing risk of a last minute postponement. They recognise that if they press for certainty now they may well precipitate an early decision to move Impact Day to 23 November. If, however, against Kleinwort's wishes Ministers were to take a decision to postpone, Kleinwort's would want to know as soon as possible.

(b) Postpone the Autumn Statement until December

31. Once spending decisions on all the main programmes are agreed there would be no possibility of delaying the Autumn Statement without damaging leaks and speculation. This would be an unpromising background for the BT sale and could raise problems over disclosure. Although as a matter of strict law it may subsequently be the case that there is no element in the Statement which has a particular impact on BT or the telecommunications industry, the immense size of the flotation makes it imperative that there are no legal doubts about non-disclosure. In addition, if the Government is to act in accordance with the highest standards of propriety, disclosure of the main elements of the Autumn Statement would be appropriate once they are known.

32. So this option would require an early decision to reschedule the programme of Star Chamber and trilateral meetings over six weeks instead of three to allow Cabinet to take decisions early in December. The arrangements recently agreed with the Prime Minister and Cabinet would need to be changed and there would inevitably be a loss of momentum in the public expenditure discussions. The outcome for the Treasury need not necessarily be worse. But because we would no longer be able to use the threat of disruption to BT as an argument with spending Ministers for settling on Treasury terms, and because of the general loss of momentum, there must be a distinct risk that the outcome would be worse.

33. As far as BT is concerned, this course need not raise problems of disclosure in the Prospectus, so long as relevant decisions on public expenditure programmes and totals had not yet been taken before 16 November. But rumours about the outcome of public expenditure discussions might well damage the pricing and underwriting of BT up to 16 November or discourage subscriptions during the application period between 16 and 28 November. A lesser risk is that the market might react badly to the Autumn Statement when it came out shortly after the start of dealings in BT. This could give rise to some disgruntlement, although presumably the BT share price would not react differently from the market in general. We might have to consider preparing the markets a little if the public expenditure discussions began to run into trouble.

34. There could also be problems if the review of National Insurance Contributions led to decisions which required legislation this year: early December would be too late to secure all the Commons stages by Christmas and Royal Assent by end-January (to enable DHSS to print new contribution tables and employers to adjust their payrolls for the new contribution year beginning in April.) Arrangement would have to be made to announce the NICs separately.

35. But the crucial point about this option (as of option (a)) is the question of timing. A decision to postpone the Autumn Statement until December, if it is to be taken at all,

ought to be taken very soon if the Star Chamber programme is to be rearranged so that Cabinet arrives at its expenditure decisions early in December rather than early in November (so as not to run any risks over disclosure in relation to the BT prospectus.)

36. Kleinworts' clear advice is against any postponement of BT Impact Day, on the grounds of its potential damage to the sale. Faced with a choice of evils they would rather postpone the Autumn Statement.

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(c) Go Ahead with the Present Timetable

37. Given the potential damage to the BT sale of early postponement either of Impact Day, or the Autumn Statement, we have looked again at the public expenditure timetable to see if there is any way of improving the likelihood of Cabinet settling the final figures on 8 November. In doing so we have consulted the MISC 106 secretariat (Mr Gregson and Mr Buckley).

38. At present, MISC 106 are allowing themselves three full weeks to reach their conclusions and draft a report (which would go into the Prime Minister's box on Friday 2 November, so as to enable circulation to Cabinet early the following week.) This timetable allows two weeks - plus a little more - to conduct discussions on the disagreed programmes, and about a week for Prime Ministerial trilaterals. Compressing the first two weeks plus would be mechanically difficult, given the absence abroad of a number of Ministers during that period. More important, there would be a risk of it leading the Star Chamber to a less ambitious view of its task: its members might feel that, if they were not being given time to consider these difficult issues thoroughly, they would be obliged to report back to the Cabinet with no more than an extended series of options, with little further agreement. On the other hand, compressing the final weeks so as to allow a Cabinet discussion on 1 November would either mean cramming what will probably be a longish list of trilaterals into an implausibly short space in the Prime Minister's diary; or

would imply no more than a general discussion at the 1 November Cabinet of a second-reading character. This would, perhaps, be a sure recipe for worsening the prospects of a satisfactory final outcome.

39. The only other possible acceleration would be to aim for a Cabinet discussion on Tuesday 6 November, which would allow the 8 November as a possible second Cabinet if decisions could not be reached on the 6th. This timetable - which carries with it the publicity penalty of a Tuesday Cabinet, with the possible aura of difficulty and crisis - would still place implausible demands on the Prime Minister's diary (it would be necessary to finalise the MISC 106 report for her box on Wednesday 31 October.)

40. Bringing forward the 8 November Cabinet, therefore, looks unlikely, or damaging to the Treasury's public expenditure objectives. But, given the extreme difficulty of the policy issues with which MISC 106 will be concerned, we think it likely that some Cabinet discussion will be thought necessary on a number of issues on the 8th, to ensure that colleagues are content to support what has been recommended ora greed by MISC 106 or the trilaterals. That is certainly the Cabinet secretariat's view, and it carries with it a clear risk that a single Cabinet meeting (especially if other items are on the agenda) will not give enough time to settle all the outstanding issues, without any - or very few - loose ends. (To meet our unprecedentedly tight printing/duplicating timetable for the Autumn Statement we can afford scarcely any loose ends after the 8 November Cabinet.)

41. Our conclusion is that, with the best will in the world, and a considerable sense of urgency all round, there must be a strong risk that our existing timetable will fail to deliver an Autumn Statement on 12 November. The Cabinet secretariat would put it rather more strongly than that. That is, perhaps, a cautious view. But at best, the odds are, in our judgement, against success.

42. But at that stage (and this might not become apparent until very close to 8 November or - at worse - until the 8th Cabinet) a short postponement of Impact Day would be virtually impossible, without imperilling the whole sale. At the same time, keeping Impact Day but postponing the Autumn Statement into December could run us into potentially severe disclosure problems. There might be no alternative but to pull the BT operation altogether for a more favourable time.

Summary of Options

43. To sum up, three things have come out of this further review.

- (a) First, the existing timetable, with the Autumn Statement on 12 November and Impact Day on 16 November, is far superior to any other options available provided public spending is settled by Cabinet on 8 November.
- (b) Second, if for any reason, we fail at the last minute to get expenditure settled, there will be no satisfactory fall-back position. Ministers might then have to face deferring the BT sale until a more favourable time.
- (c) Third, and this is the most crucial point, if you and Prime Minister judged that more time needed to be allowed to settle public expenditure, either by deferring BT a week or deciding now to put back the Autumn Statement to December, the decision needs to be taken without delay, and certainly during the course of next week.

In short, instead of a preferred course with a less attractive fall-back position if that course fails, we have a number of mutually exclusive options from which a choice has to be made quickly. The Annex presents the choice in summary form. I am sorry that none of them is free from risk.

D. WINTER SUPPLEMENTARIES

44. Our present assumption is that the Autumn Statement will announce that we expect a public expenditure overrun in 1984-85. Some indication of this overrun will also be apparent from the Winter Supplementaries (which include £500 million extra for DHSS, £500 million for ECGD and £100 million for extra Police costs.) It would be undesirable, therefore, to publish the Winter Supplementaries before the Autumn Statement. However, even if they were to be published on Autumn Statement day (as happened last year) our 1981 undertaking to give proof copies of the Supplementaries, in confidence, to the Departmental Select Committees a few days (usually more than 7) in advance would also be very risky, given the nature of the information they will contain.

45. If we were not prepared to release the Winter Supplementaries in advance of the Autumn Statement we would run into considerable problems if the Autumn Statement were delayed until early December. It would be difficult to secure the passage of the Consolidated Fund Bill before the Recess (and then only by reducing substantially the period normally allowed for scrutiny by Select Committees before formal presentation of the Estimates.) Were the Bill delayed until January, there is a risk that some departments would run out of money. Moreover, although the figures are very uncertain, the sums could be sufficient to exhaust the Contingencies Fund. If this happened during the Recess there would be no mechanism to redress the position, and we would be forced to take exceptional and unprecedented action such as deferring payments, and withholding grants for a week or so.

46. This is a risk we cannot run: so we will either need to release the Winter Supplementaries ahead of the Autumn Statement (which may cause adverse publicity about expenditure being out of control, notwithstanding earlier softening up of opinion); or have the Autumn Statement in November.

Conclusions

47. The main conclusions seem to be as follows:

- (a) so long as Ministers can settle the public expenditure figures by 8 November there is no reason why you should not plan to announce them in a Statement to the House on Monday 12 November, ahead of the debate on the economy the following day and BT Impact Day on the 16th;
- (b) a two-part operation with the Oral Statement on the 12th, supported by Treasury press notices, the GAD Report and the National Insurance Orders, and the printed Statement on the 15th, looks feasible; but this has a number of unattractive features and might not be well received;
- (c) the alternative is to plan to publish the full Autumn Statement on Monday 12th after your Oral Statement. This means cutting 3 days off the usual timetable; it looks just feasible provided Ministers are in a position to approve the final text and figures at least by lunchtime on Saturday 10th - but there would be little or no margin for slippage;

But

- (d) more crucially, there is an urgent need to decide whether it is safe to rely on securing public spending decisions by 8 November, rather than take one of the other options in paragraph 27.

2 cables to be discussed with PM

AMB

A M W BATTISHILL

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B
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Wilson

SECRET

Options

Advantage/Upside
Risk

Disadvantage/Downside
Risk

A Continuing to try for timetable agreed before holding: AS 12 November (instead of 13 November) and BT 16 November

Best outcome if PEX decisions ready for 12 November

High risk of failing to deliver acceptable PEX decisions. So high risk of forced 'late' postponement of BT, which would

- add to cost of advertising etc
- look extremely incompetent
- upset market/reduce sales value of BT;
- could well lead BT to be pulled ie postponed till New Year

B Defer by one week ('Early' postponement)

Should allow AS to precede BT.

Kleinwort strongly opposed (Extra cost of advertising etc Looks incompetent) but less (Could upset market) than A Lower BT proceeds than A (upside): breaks marketing momentum; Excessive pathfinder period. Risk of failing on both counts. AS not ready by 19 November

C Defer AS to, say, 7 December; Leave BT on 16 November

BT on time and not endangered by public expenditure slippage

Slow down weakens momentum of PEX discussions; final public expenditure outcome may be worse than in B.

Lose opportunity of telling recalcitrant spending Ministers that they are endangering BT flotation.

Extended PEX discussions leak and damage market for BT.

Difficult to present new timetable possible disturbance to markets and hence BT proceeds;

Possible disclosure problems but fair chance of avoiding

Also
NI Review has to be announced separately and early

So do Winter Supplementaries

mp

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FROM: JON SHIELDS
DATE: 12 October 1984

CHANCELLOR

(Handwritten notes in red ink, including "White Paper")

(Handwritten notes in red ink, including "Council")

(Handwritten notes in red ink, including "roll of the Public")

(Handwritten notes in red ink, including "rate 7/8")

- cc Chief Secretary
- Financial Secretary
- Economic Secretary
- Minister of State
- Sir Peter Middleton
- Mr Bailey
- Sir Terence Burns
- Mr Anson
- Mr Cassell
- Mr Kemp
- Mr Monck
- Mr Battishill
- Mr Lavelle
- Mr Evans
- Mr Odling-Smee
- Mr Scholar
- Mr Sedgwick
- Mrs Case
- Mr Culpin
- Mr Gray
- Mr Mowl
- Miss Peirson
- Mr Riley
- Ms Seammen
- Miss Sinclair
- Mr Stibbard
- Mr Horton
- Mr Stock
- Mr Grice
- Mr Pratt
- Mr Ridley
- Mr Lord
- Mr Portillo

ECONOMIC ASSUMPTIONS

This submission seeks your approval for the main economic assumptions affecting public expenditure which will be published in the Autumn Statement, the next Public Expenditure White Paper and the November Report of the Government Actuary. It also covers some important unpublished figures such as interest rates. The proposals have been agreed with the Public Expenditure sector.

2. A full listing of the proposed assumptions is provided

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In Annex A. Also shown for comparison are the equivalent figures provided to Departments in July and, where relevant, the last published figures. Annex B spells out the reasons why the figures are needed and where and when they will appear. It is possible that some figures for later years, timed for publication in the PEWP, may be elicited beforehand under questioning if Planning Totals for these years are announced in advance.

3. The following paragraphs summarise the main proposals and consider presentational difficulties that may arise. Following the conclusions of the Anson Report on Demand-Led Expenditure, the line taken is that the underlying assumptions should be as realistic as possible to ensure the efficient monitoring and forecasting of Public Expenditure. The background to the latest proposals is the October Treasury Economic Forecast (TEF) circulated by Mr Evans on 12 October.

Separate
fside

Inflation

4. The outlook for inflation in early 1985 has deteriorated since the time of the Budget, mainly because of falls in the exchange rate index and - as far as the RPI is concerned - higher interest rates. The Budget forecast for RPI inflation to May 1985 was 4 per cent, but this was revised up for Departmental purposes to 4½ per cent in July. The forecast now suggests an increase of 5 per cent.

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page 4 3/4 6

RPI
(per cent rise on previous May)

	May 1985	May 1986	May 1987
March FSBR	4	-	-
July (unpublished)	4¾	4	3½
Proposals	5	4	3½

5. The figure of 5 per cent for May 1985 is at the bottom end of most outside forecasts, which are looking to RPI inflation

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in the range of 5-6½ per cent next year. Nevertheless, there is a risk that forecasting even a modest rise in RPI inflation by next spring (the September 1984 figure is 4.7 per cent) could have repercussions on wage negotiations this autumn. Many important manufacturing settlements are due before Christmas. In addition, the 1 million local authority manuals (settlement date 4 November) typically set the target for the rest of the public services, and Pay division already expects the negotiations to be difficult this year. The possibility that the forecast rise in inflation over the next few months could be seen as indicating a permanent worsening in the inflation outlook should be reduced by the inclusion also in the Autumn Statement of a forecast for the RPI increase between 1984 Q4 and 1985 Q4. On present trends, we shall probably be proposing a figure of 4½ per cent for this period. The eventual publication of the profile for later years should help confirm the intended downward path for inflation.

6. The profile for the GDP deflator can deviate quite substantially from that of the RPI in the short term. Differences can reflect coverage (particularly the inclusion of the mortgage rate in the RPI) and the impact of import prices. Nevertheless, forecasts of both the GDP deflator and the RPI have been revised up by similar amounts since the Budget: the GDP deflator from increases of 4¾ per cent in 1984-85 and 4¼ per cent in 1985-86 to just over 5 per cent in both years. We propose to show these increases as 5 per cent in the Autumn Statement.

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GDP Deflator

(per cent changes on previous year)

	1984-85	1985-86	1986-87	1987-88
March MTFS	4¾	4¼	4	[3½]
July (unpublished)	4¾	4¾	4	3¼
Proposals	5	5	4¼	3½

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The proposed revisions to the assumptions for the first two years will of course imply lower levels in cost terms of given cash totals for public expenditure in all future years. But of more tactical concern may be the higher rates of increase proposed for the deflator in the later years, 1986-87 and 1987-88. In 1987-88, the size of the large additional bids for the defence and health programmes may be affected, since the departments concerned are arguing for (at least) no real reductions in their programmes for that year. And in the July discussion of the Planning Total for 1987-88, Cabinet colleagues were told that the 3 per cent uplift would not imply a squeeze on present forecasts of inflation.

7. The approach adopted in July was to shade down marginally the figure for 1987-88 to 3¼ per cent. We recommend moving back to 3½ per cent now because of the higher path in earlier years. But there are clearly attendant risks.

8. There is some uncertainty about when the assumptions on the deflators for later years will be made public. In correspondence with the Select Committee, it was indicated that such assumptions would be available when new Planning Totals for the Survey Period were revealed in the PEWP. With the possibility of an announcement being made in this year's Autumn Statement, bringing forward publication of deflators up to 1987-88 must also be contemplated. This would certainly be necessary if full revenue projections were also provided. In this case, consistency with medium-term paths for money and real GDP must be ensured and a further note will be submitted to you, outlining the options open for a formal update of the fiscal projections in the MTFS.

9. The projections of average earnings need to reflect the effects of the miners' dispute (which has helped to take the index in recent months as low as 5¼ per cent up on a year earlier). On the assumption that the dispute is over towards the end of this calendar year, the rate of increase between 1983-84 and 1984-85 may be reduced on this account by about 2/3 per cent. Thus our "underlying" projection of a year-

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Year-on-year rise of 7½ per cent - consistent with recent "underlying" monthly figures - would come down to just under 7 per cent. This in turn is identical to the last published forecast for 1984-85 (the Government Actuary's Report in July). It will not, however, allow us to escape the implied message that our "underlying" figure must have been revised upwards since then. Some adverse comment may result.

10. For 1985-86, the presentational difficulties on average earnings will be more severe. Although our forecast assumes some small decline in the "underlying" rate of increase, the assumption that the year 1985-86 will be unaffected by the miners' dispute means that the year-on-year change will be raised by about 2/3 per cent. This takes the annual growth rate up to 7½ per cent compared with 7 per cent for the preceding year, giving the impression of a re-acceleration. To reduce this risk of misinterpretation, however, we propose to ask the Government Actuary to explain this statistical quirk in the paragraph he traditionally incorporates in his Report about the Treasury's assumptions. A similar line would be taken in the Autumn Statement. No precise figuring on the miners' dispute would be given.

Average Earnings
(per cent increase on year earlier)

	1984-85	1985-86	1986-87	1987-88
July GAD	7	-	-	-
July (unpublished)	7	6½	6	5
Proposals	7	7½	6	5

11. Even without the problems arising from the miners' dispute, the projections that average earnings will grow at about 7½ per cent this financial year and slightly less next year could be taken as rather gloomy signals to the labour market. Whilst the figures are lower than many recently getting currency in the Press (such as the 8.1 per cent increase from the NES or settlement and claims for Jaguar and Vauxhall) they are not

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ambitious. We do not, however, believe that a much smaller figure for this year would be credible given the importance of settlements already concluded. For next year, slower growth would imply clearly lower settlements in the 1984-85 pay round just beginning. There are no signs to date of this happening - if anything the reverse. Virtually all outside forecasters are assuming that settlements will stay at similar levels in this pay round to last year or be slightly higher.

12. There is no question of publishing the earnings assumptions for later years. For 1986-87 the proposed projection of a 6 per cent increase tracks the TEF. The proposed deceleration in 1987-88 to 5 per cent is chosen to be consistent with the paths for prices.

Unemployment

13. Unemployment has again been rising faster than expected. The figure for GB had reached nearly 3.0 million by September, compared with the figure for the financial year average of 2.85 million published in the Budget and retained in the July GAD Report. The forecast now looks to unemployment rising at about 15,000 a month for the remainder of this financial year, implying an average figure of nearly 3.0 million in 1984-85 and a level approaching 3.1 million by March 1985. For 1985-86, the forecast suggests some slowing-down in the rate of increase of unemployment, perhaps flattening-off later in the year. An average level of 3.1 million is projected for the year.

v. difficult to include a rising trend. why not 3.0 for all years?

14. The last time projections were published for both years was in the February 1984 PEWP, at a steady level of 2.85 million. We now propose to show a path which rises initially - 3.0 million in 1984-85 and 3.1 million in 1985-86. Such a profile is not unusual. On several previous occasions, assumptions have been published which have shown an average level in the first full year some way above the latest actual. For later years, however, the assumption of a flat path (this time at 3.1 million) is fairly conventional. In general, it is not intended to be,

It is dangerous to assume a change in the trend. Look at the chart.

Why not have a flat 3.0 for all years or 3.1 for all years (or 3.05 for all years)

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and typically will not be, consistent with the path of GDP underlying updated fiscal projections. Figures will also be shown for school leavers and temporarily stopped and for Northern Ireland.

Unemployment

(GB, narrow, millions)

	1984-85	1985-86	1986-87	1987-88
February PEWP and July GAD	2.85	2.85	2.85	-
July (unpublished)	3.0	3.0	3.0	3.0
Proposals	3.0	3.1	3.1	3.1

15. Outside forecasters are in general not optimistic about the outlook for unemployment. Most see further increases through 1985 and beyond.

Interest Rates

16. Interest rate assumptions are not published. But their importance to public expenditure projections has been highlighted by the effects on ECGD costs of the unexpectedly high levels ruling over the summer. The assumptions circulated to Departments in July reflected financial developments in the summer and it is only proposed to make very minor changes to the UK figures now for 1984-85. The average levels proposed are for short-term UK rates of 10¼ per cent and long-term rates of 10¾ per cent, consistent with the October TEF. A small reduction to 12 per cent for the financial year average for the 6-month Libor dollar rate is also proposed.

17. Prospects for a sharp reduction in UK interest rates next year do not, however, look as good as in July. We propose to use the TEF figures for 1985-86 of an average of 9¾ per cent for short rates and 10½ per cent for longs. Dollar rates are expected to remain firm, giving an average of 12¼ per cent

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For the 6-month Libor rate.

18. In later years, the decline in inflation is consistent with reductions in both short and long UK interest rates. Short-term dollar rates are, however, assumed to decline rather more slowly. Such a widening of the UK-US interest rate differential is probably not consistent with the assumption conventionally made in public expenditure projections that exchange rates remain unchanged. This is probably not important for the planning totals, but the implications for some individual programmes will have to be kept in mind.

Implications for Public Expenditure

19. The economic assumptions proposed above would have a substantial effect on projections for the total of public expenditure. Compared with the assumptions provided to Departments in July, the impact in 1985-86 would be to raise the total programme figures by just over £400 million. This breaks down roughly as follows:

Unemployment - £220 million
Prices - £75 million
Interest Rates - over £100 million

The effect of 1986-87 and 1987-88 of all the proposed changes would be slightly larger - about £500 million in each year. Ready-reckoners for the impact of representative changes in the assumptions on public expenditure figures are shown in Annex C.

20. The assumptions agreed now will form the basis for the Autumn Statement and also the next PEWP, although the figures are due to be updated internally next January if the outlook changes significantly.

Timetable

21. Because of the major effect of new economic assumptions

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will have on certain programmes in 1985-86 and beyond, they need to be worked into public expenditure figures as soon as possible. Without them, it will not be possible to conduct the discussions in the Star Chamber on a satisfactory basis. The aim is to settle the assumptions on Monday. Meanwhile, the Treasury paper for MISC 106 shows a single line of provisional adjustment on account of revised economic assumptions of £400 million, £500 million and £500 million in the three Survey years; and once decisions have been taken about the assumptions to be published they will be reflected in departmental programmes as soon as possible.

22. You may wish to consider whether No 10 should be consulted at this stage about the figures to be published. It would nevertheless save time if the calculations could be started in advance of formal approval being obtained.

23. We shall be available to discuss these issues at your meeting on Monday, 15 October at 2.30pm.

J. V. S.

JON SHIELDS

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LIST OF ECONOMIC ASSUMPTIONS +

	May 1985	May 1986	May 1987	
<u>RPI per cent change May on May -</u> May 1985 figure published in Industry Act Forecast; later years in PEWP				
February PEWP	4½	4		
March F'SBK	4			
July (unpublished)	4¾	4	3½	
October forecast	5.0	3.7		
Proposed	<u>5</u> 4¾	<u>4</u>	<u>3½</u> 3½	
<u>Unemployment GB narrow (million) -</u> Published for 1984-85 and 1985-86 in GAD Report; later years in PEWP	1984/5	1985/6	1986/7	1987/8
February PEWP and July GAD	2.85	2.85	2.85	
July (unpublished)	3.0	3.0	3.0	3.0
October forecast	3.0	3.1	3.1	
Proposed	<u>3.0</u> 3.05	<u>3.1</u> 3.05	<u>3.1</u> 3.05	<u>3.1</u> 3.05
<u>Average earnings per head -</u> Published for 1984/5 and 1985/6 in GAD Report; later years not published	1984/5	1985/6	1986/7	1987/8
July GAD	7			
July (unpublished)	7	6½	6	5
October forecast (adjusted for miners' strike)	6.9* (7½)	7.6* (7)	6.4	
Proposed	<u>7*</u> 7	<u>7½*</u> 7	6	5
<u>GDP deflator per cent change -</u> Published for 1985/6 with Autumn Statement; later years in PEWP and perhaps Autumn Statement	1984/5	1985/6	1986/7	1987/8
March MTFs	4¾	4¼	4	3½
July (unpublished)	4¾	4¾	4	3¾
October forecast	5.1	5.3	4.2	
Proposed	<u>5</u>	<u>5</u>	<u>4¼</u>	<u>3½</u>

? use July line

+ Figures underlined are those needed for publication

* Figures affected by the miners' strike

?

Interest Rates
3 month interbank (not published)

	1984/5	1985/6	1986/7	1987/8
July	10 $\frac{1}{2}$	9	7 $\frac{1}{2}$	6 $\frac{1}{2}$
October forecast	10.2	9.7	8.7	
Proposed	10 $\frac{1}{4}$	9 $\frac{3}{4}$	8 $\frac{3}{4}$	7 $\frac{1}{2}$

20 year gilts (not published)

	1984/5	1985/6	1986/7	1987/8
July	11	10	8 $\frac{3}{4}$	7 $\frac{1}{2}$
October forecast	10.7	10.3	9.5	
Proposed	10 $\frac{3}{4}$	10 $\frac{1}{2}$	9 $\frac{1}{2}$	8

6 Month Dollar LIBOR (not published)

	1984/5	1985/6	1986/7	1987/8
July	12 $\frac{1}{4}$	12	11 $\frac{1}{2}$	11
October forecast	11.9	12.2	11.7	
Proposed	12	12 $\frac{1}{4}$	11 $\frac{3}{4}$	11

PUBLICATION OF ECONOMIC ASSUMPTIONS

	AUTUMN STATEMENT	GOVERNMENT ACTUARY'S ANNUAL REPORT	PUBLIC EXPENDITURE WHITE PAPER
DATE DUE	November	November	January/ February
UNEMPLOYMENT	Financial year averages for 1984-85 and 1985-86 shown as basis for estimates of expenditure on social security.	Financial year averages for 1984-85 and 1985-86 shown as basis for estimates of expenditure on social security.	Financial year averages up to 1987-88 shown as basis for estimates of expenditure on social security.
RPI	Annual percentage change to May 1985 shown as basis for estimates of expenditure on social security. The Industry Act Forecast will also show annual percentage changes to 1984Q4 and 1985Q4.	Annual percentage increase to May 1985 shown as basis for estimates of expenditure on social security.	Annual percentage increases up to May 1987 shown as basis for estimates of expenditure on social security.
AVERAGE EARNINGS	<u>As for GAD</u> Internal TEF forecast used to derive published estimates of government revenue.	Average growth rates to 1984-85 and 1985-86 shown as basis for estimates of income from NI contributions.	<u>Not shown.</u> But used for calculating family income supplement and housing benefit.
INTEREST RATES	<u>Not shown</u> but figures for 1983-84 and 1984-85 used as basis for estimating expenditure on various programmes (eg interest support costs, housing).	Not relevant.	<u>Not shown,</u> but figures up to 1986-87 used as basis for estimating expenditure on various programmes and debt interest payments.
GDP DEFLATOR	Will probably need to show 1985-6 deflator consistent with the IAF. Later years will also be necessary if a three year expenditure profile is provided.	Not relevant.	Financial year percentage changes up to 1987-8 to determine cost terms for public expenditure.

Effect of Changes in Assumption on Public Expenditure Planning Total

£ million
1985-6 Expenditure

Rise of 100,000 in unemployment

DHSS	220 ¹
------	------------------

One point rise in sterling interest rates

ECGD	60
Housing	65

One point rise in dollar interest rates

ECGD	60
------	----

½ per cent rise in May RPI

DHSS	70 (190 in a full year)
------	-------------------------

Plus the impact on negotiations with
 Departments concerned about "volume"
 commitments:

½ per cent rise in GDP deflator

Defence in 1985-6	62
DHSS	15 ²

1 £200m in later years.

2 A further £15m expenditure is conditional on an unchanged GDP deflator assumption for 1985-86.

(12/05/84)
*[Can we get a
wh. a given month
from target can be hit
with a higher PSBR with
a higher interest rate?]*

Unusually large \$, oil, int. rates

COPY NO

myo

SECRET AND PERSONAL

FROM: HUW EVANS
12 October 1984

*① Corp Tax
② Govt/State
③ PSBR - p11 - follow
④ £/\$ exchange rate*

CHANCELLOR

- cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
PCC
Mr Burgner
Mr Lankester
Mr Lavelle
Mr Monger
Mr Odling-Smee
Mr Scholar
Mr Sedgwick
Mr G Watson
Mr Folger
Mr Mowl
Miss Peirson
Mr Shields
Mr Stibbard
Mr Ridley
Mr Lord
Mr Portillo

C
*The reassessing fiscal adjustment
for 85-6 about the only
reassessing element in the forecast -
looks v. vulnerable to oil price
2 \$ movements. what price, really,
an average £/\$ ex rate of
1985 of 1.31*
HP
*Shields's analysis re: 11
congruence*

*[Mr. for 1984-85, re
with the help of
PSBR account = forecast
and assumptions]*

*assessing of
Jan 70s on rise
of price - gas
? productivity
assessing*

OCTOBER FORECAST

I attach the report on our internal forecast. A detailed report on the fiscal prospects is being circulated today by Miss Peirson.

2. Proposals for economic assumptions for use in the current discussions on public expenditure, in the Autumn Statement and in the GAD annual report are being circulated separately today by Mr Shields. These proposals are consistent with the forecast in this report.

HPE

H P EVANS

ENC

SECRET AND PERSONAL

MEEVANS
2/10
OCTOBER
FORECAST

SECRET AND PERSONAL

TREASURY ECONOMIC FORECAST

OCTOBER 1984 REPORT

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Annex: comparison of forecasts

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SECRET AND PERSONAL

TREASURY ECONOMIC FORECAST: OCTOBER 1984 REPORT

Introduction

This is the report on the (internal) October exercise. Detailed reports are (or very soon will be) available as follows:

Public finances, Miss Peirson (PSF).

Oil production and revenues, Mr Hacche (EA2).

Financial forecast, Mr Mowl (EA2).

World economic prospects, Mr Patterson (EF2).

2. Data becoming available since the budget forecast have been mostly consistent with our earlier forecasts of inflation, output, borrowing, and monetary growth. Differences include higher US and UK interest rates, and a lower exchange rate. The miners' strike is reducing production and the trade surplus and increasing the PSBR. These are the direct effects: there are probably also effects on exchange rates, interest rates and business confidence.

3. For the world economy we expect, like most forecasters, continued but slower growth in the US (perhaps a recession by 1986) not fully offset by somewhat faster growth in some European countries. We have not allowed for major upheavals in the debt or banking worlds: our forecast looks consistent with these problems slowly getting better, in aggregate, at least after 1985. A world of high interest rates and large debts (many of poor quality) has, however, considerable deflationary potential.

SUMMARY OF UK FORECAST

4. The next 8 pages summarise the forecast in words and numbers. A table on pages 9-10 summarises our latest assessment of the UK, alongside the budget forecast. An annex to this forecast provides comparisons with earlier Treasury forecasts and with outside forecasters.

The fiscal prospect

5. The fiscal prospect is set out in detail in a separate report by Miss Peirson. Our forecasts of the PSBR and fiscal adjustment compare with the budget forecast as follows (both forecasts assume a PSBR set at 2 per cent of GDP in 1985-86 and 1986-87):

	<u>PSBR</u>			
	(fiscal adjustment in brackets)			
	£ billions			
	1983-84	1984-85	1985-86	1986-87
Budget forecast/MTFS	10	7 ¹ / ₄	7 (2)	7 (4 ¹ / ₂)
October forecast	10	8 ³ / ₄	7 (3)	7 ¹ / ₂ (4 ¹ / ₂)

The fiscal adjustments, expressed in annual not cumulative terms, are not very different from the MTFS (though a little higher in 1985-86): public expenditure is higher but so is revenue (above all, from the North Sea).

6. At this time of year, errors of £2 billion or more on the current year PSBR are common: the unknown duration and cost of the miners' strike add an additional uncertainty. Our estimate of the fiscal position in 1985-86 could change by several billion, either way, before the budget. Flows on each side of the public sector accounts in 1985-86 approach £200 billion.

7. The PSBR in 1984-85 is now forecast at £8³/₄ billion, some £1¹/₂ billion higher than in the FSBR. Higher expenditure (including around £1¹/₄ billion for the miners' strike, £¹/₂ billion for the EC, £¹/₂ billion for debt interest owing partly to higher interest rates, and £¹/₂ billion of LA capital

SECRET AND PERSONAL

overspend, partly offset by nearly £ $\frac{1}{2}$ billion extra asset sales) more than offsets an increase of £ $1\frac{3}{4}$ billion in North Sea taxes.

8. In 1985-86, too, the forecasts of expenditure and revenue are both higher than in the MTFs. But the increase in revenue may be greater: and the prospect is for a fiscal adjustment higher than the £2 billion in the MTFs. Higher expenditure includes around £1 billion for social security benefits, £ $\frac{1}{2}$ billion for no net underspend on cash limits, £ $\frac{1}{2}$ billion for the EC, and £ $\frac{3}{4}$ billion for debt interest, partly offset by £ $\frac{1}{2}$ billion extra asset sales. The higher revenue includes £3 billion extra on North Sea taxes and increases of around £ $\frac{1}{2}$ billion each on personal taxes, expenditure taxes, and £ $\frac{1}{4}$ billion on onshore company taxes and National Insurance contributions, partly offset by reductions in other receipts.

9. The relationship between our forecasts for expenditure and the plans are explored in detail in Miss Peirson's report on public finances. The position in 1985-86 looks as follows:

<u>The plans</u>	1985-86, £ billion
Planning Total target	131.7
(of which reserve	3.8)
GEP's July assessment of possible outcome of extra bids and cuts	+1.5
Extra asset sales (revised view)	-0.5
Probable effect of revised economic assumptions	+0.4
Reserve implied to keep to planning total target	2.3

*Integrate,
clearly.*

The forecast

Forecast of planning total, taking account of likely overspends, contingencies etc	133.0
Excess of forecast over plans	+1.3

10. Overspending by local authorities, higher social security payments (including further increases in take-up), failure of nationalised industries to meet new targets - these are some of the main factors behind the forecast overrun. The message of the forecast is that plans of 131.7 for next year are liable to be substantially overspent - unless programmes are cut more than at present envisaged and the Reserve correspondingly increased.

11. Comparisons between the public expenditure plans and the October forecast are given in the table below:

	<u>Planning Totals</u>			
<u>cash, £ billion</u>	1983-84	1984-85	1985-86	1986-87
MTFS	120.3	126.3	131.7	136.2
October forecast	120.5	128.0	133.0	139.0
<u>cost terms, £ billion,</u> <u>1982-83 prices</u>				
MTFS	114.1	114.2	114.3	113.7
October forecast	115.5	116.8	115.3	115.7
(includes effects of revised inflation projections)				

12. The forecast suggests that it will be increasingly difficult to keep public expenditure within the targets: the gap between the PEWP figures and the forecast widens steadily. This reflects in part the usual difficulties with local authorities, and the tendency for pay in the public services as a whole to rise considerably faster than is implicit in the cash plans, though still a little more slowly than in the private sector.

13. Even with this level of overspending, projection of public spending in cost terms falls in 1985-86 (following a rise in 1984-85), and remains roughly constant in 1986-87. The forecast embodies a cash limit squeeze on volumes in the cash limited area of central government equivalent to $3\frac{3}{4}$ per cent in 1986-87, mostly on employment, rising to around 2 per cent in 1987-88. With the planning total forecast to fall in real terms and the economy to grow, the ratio of public expenditure to (nominal) GDP may fall from some $42\frac{1}{2}$ per cent in 1983-84 and 1984-85 to 40 per cent by 1986-87.

14. In cash terms, there is a very sharp reduction forecast in the PSBR between 1984-85 and 1985-86, from $\pounds 8\frac{3}{4}$ billion to $\pounds 4$ billion (before fiscal adjustment). The miners' strike adds $\pounds 1\frac{1}{4}$ billion to the PSBR in 1984-85: offsetting this is the once-for-all change in VAT on imports. The main reason for the decline in the PSBR between the two years is that, whereas (ignoring the VAT change and the fiscal adjustment) total revenues are expected to rise by some $\pounds 12$ billion (9 per cent), much in line with the growth in nominal GDP, the public expenditure planning total is forecast to rise (ignoring the miners' strike) by only $\pounds 6$ billion (under 5 per cent).

15. Against this background, the plausibility of the size of the fiscal adjustment can be judged. While we have made the usual assumption that it takes the form of lower income tax, some of it may well prove to be pre-empted by more expenditure which could well turn out above what is in this forecast and even more above the targets in the last White Paper.

16. Since the FSBR, our projections of oil revenues in 1985-86 have been revised up by $\pounds 3$ billion; and our assumption on asset sales by a further $\pounds 1\frac{1}{2}$ billion. Neither increase is fully sustainable in the longer run, and the effects on interest rates of higher asset sales at least are much less than for cuts in expenditure. This forecast continues to assume a 2 per cent PSBR ratio up to 1986-87, which, given these changes, implies an easier fiscal stance than earlier envisaged.

The financial forecast

17. Despite the higher PSBR forecast for the current year, we still expect the growth of £M3 to stay below the top end of the 6-10 per cent range. Next year, with a lower PSBR and some slowdown in the growth of private sector credit demand, £M3 growth should be within the 5-9 per cent MTFs range. The growth of narrow money M0 should also continue within its ranges. We think that these and other developments in the forecast would be consistent with some decline in UK interest rates, even though in the US rates may stay up well into 1985 before slowly falling as that economy moves towards recession. Market expectation of dollar weakening - often forecast, not yet realised - may allow UK (and European) rates to say 2 points or more below US rates.

18. The assumed ending of the miners' strike and the associated recovery in the current account surplus, together with doubts about the dollar, could be enough to steady the value of sterling, possibly with a gentle rise in 1985.

The miners' dispute

19. We make the convenient assumption that the dispute ends in December. Production of coal gets back to normal early in 1985, having reduced GDP in 1984 by about 1 per cent and worsened the balance of trade by some £2 billion. The indirect effects of the dispute, on financial markets, on business confidence, on consumer spending are hard to gauge: we assume a slightly higher exchange rate and lower interest rate following the end of the dispute. The costs of the dispute to public finances in the current financial year are assumed to be met by extra borrowing.

20. There are widespread effects from the dispute: in addition to output, the figures for earnings, personal incomes, productivity, stocks, exports, imports are all being affected. Broadly, the levels in 1984 (but only a little in 1985) are affected by the dispute, so influencing annual changes for both 1984 and 1985.

*How low
- AS?*

SECRET AND PERSONAL

Inflation and output

21. There has been little change in the UK inflation rate over the last eighteen months or so: recovery at home and abroad, with higher commodity prices, and further falls in sterling, have kept producer output prices rising at annual rates of around 5-6 per cent. Retail price rises have generally been lower, and not greatly changed since early 1983. Pay rises too have been fairly steady.

22. Is there more adjustment to come, given the present stance of fiscal and monetary policies? Some relevant considerations are:

(i) The fall in the exchange rate has had the effect of keeping up the inflation rate since late 1981; the earlier rise in the rate having reduced inflation more quickly. If or when the exchange rate steadies, a factor pushing up the inflation rate will have been removed.

(ii) Inflationary expectations over this period have generally been pessimistic - and remain so, in our view. A further fall in the expectations of inflation should help to bring down actual inflation.

(iii) Abroad, there do not appear to be strong forces making for higher inflation in industrial products or commodities.

23. Experience since 1981 confirms that prolonged recovery of output is compatible with a falling trend in inflation; but suggests that very high unemployment does not, of itself, exercise a strong leverage on inflation.

24. The assumptions of a slow fall in the (planned) PSBR and in the growth rate of the main monetary aggregates suggests a continuing slow decline in the growth of money GDP:

SECRET AND PERSONAL

	1983-84	1984-85	1985-86	1986-87
PSBR, percentage of GDP	3 ¹ / ₄	2 ³ / ₄	2	2
Growth rates:				
£M3)	9 ¹ / ₂	9	7	6
) target periods				
MO)	6	6 ¹ / ₂	5 ¹ / ₂	5 ¹ / ₂
Money GDP	8	7	8 ¹ / ₂	6 ¹ / ₂
output	3 ¹ / ₂	2	3	2
GDP deflator	4 ¹ / ₂	5	5	4

25. With a more prolonged coal strike, we have revised the forecast growth rate for output in 1984 down to 2¹/₂ per cent. In 1985, we expect to see companies continuing to spend more (especially on fixed investment, rather than stocks) and consumers benefiting from sizeable increases in real incomes derived from most sources: real earnings, employment, social security, dividends. The forecast suggests there may be little or no cyclical downturn until after 1986, despite some slowdown in the rest of the world. This is a more optimistic picture than currently suggested by the CSO's leading indicators.

per cent changes on a year earlier

	1983	1984	1985	1986
Domestic demand	4 ¹ / ₂	2 ¹ / ₂	3 ¹ / ₂	3 ¹ / ₂
of which consumer spending	4 ¹ / ₂	2	3 ¹ / ₂	4
Exports	1	6	4	2
Total output, GDP	3 ¹ / ₄	2 ¹ / ₂	3 ¹ / ₂	2
GDP less oil and miners' strike	3	3	2 ¹ / ₄	3

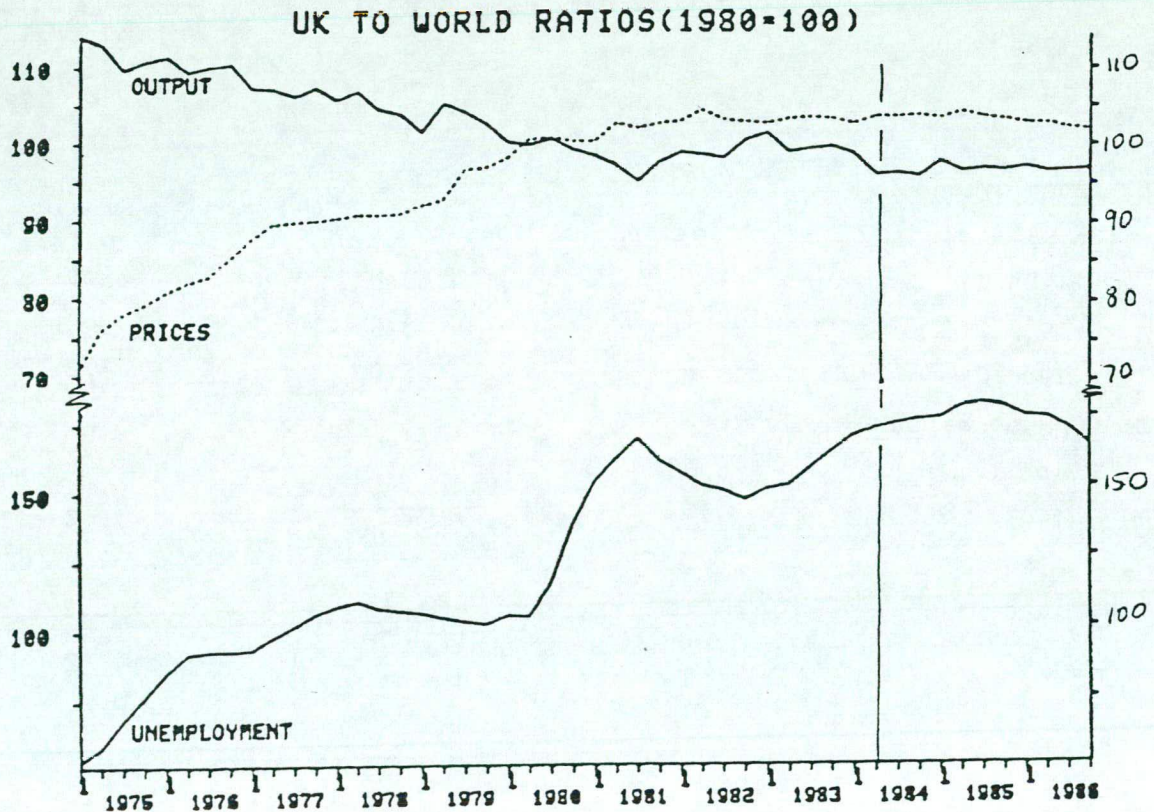
26. Continued growth of UK output should lead to further rises in employment, but with the labour force rising, and new entrants coming from outside the unemployment count, the upward trend in unemployment is expected to persist into 1985. There would be a better prospect for unemployment in the next year or two if: world and UK demand expanded more rapidly; if real wages rose less; if the rise in employment occurred in sectors- such as manufacturing - where new entrants are particularly likely to come from the unemployment register. There is a clear risk of higher unemployment in 1985 and 1986 if the higher productivity growth of recent years proves to be sustained without an equivalent growth in output.

*but a
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is
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Comparisons with the rest of the world

27. One way of looking at UK performance is by comparison with other industrialised countries. The chart below displays the ratios of UK to foreign statistics for GDP, prices, and unemployment. (Within the major 6 OECD countries, European performance has again worsened relative to the US and Japan).

28. In most years to 1981, output growth in the UK was slower, inflation higher and the unemployment rise larger. Over the most recent three years these adverse trends have not persisted.



SECRET AND PERSONAL
SUMMARY TABLE AND COMPARISON OF FORECASTS

	FSBR/MTFS MARCH 1984	OCTOBER 1984 (figures in brackets exclude the effects of the miners' strikes)
1. <u>World GNP (major 6)</u>		
1983	2	2 ¹ / ₂
1984	4	5
1985	3 ¹ / ₂	3 ¹ / ₂
1986	3	2 ¹ / ₂
2. <u>Effective Exchange Rate</u>		
1975 = 100		
1983	83	83
1984	83	79
1985	83	78
1986	83	79
3. <u>Nominal GDP (mp)</u>		
(% change on year earlier)		
1983	8 ¹ / ₂	8 ¹ / ₂
1984	8	6 ¹ / ₂ (8)
1985	7	9 (8)
1986	6	7
4. <u>GDP Volume</u>		
(% change on year earlier)		
1983	3	3
1984	3	2 ¹ / ₂ (3 ¹ / ₂)
1985	2 ¹ / ₂	3 ¹ / ₂ (2 ¹ / ₂)
1986	2	2
5. <u>Unemployment</u>		
(UK sa excluding school leavers, millions)		
1984 Q1	3.0	3.0
1985 Q1	3.0	3.2
1986 Q1	3.0	3.2
6. <u>Current Balance</u>		
(£ billion)		
1983	2	2 ¹ / ₂
1984	2	1 ¹ / ₂ (3 ¹ / ₂)
1985	1 ¹ / ₂	3
1986	1	1 ¹ / ₂

	FSBR/MTFS MARCH 1984	OCTOBER 1984
7. RPI		
(% change on year earlier)		
1983 Q4	5	5
1984 Q4	4 ¹ / ₂	4 ³ / ₄
1985 Q4	(4)	4 ¹ / ₂
1986 Q4	(3 ¹ / ₂)	4
8. PSBR and Fiscal Adjustment		
(annual not cumulative)		
(£ billion)		
1983-84	10	9 ³ / ₄
1984-85	7 ¹ / ₄	8 ³ / ₄
1985-86	7 (2)	7 (3)
1986-87	7 (4 ¹ / ₂)	7 ¹ / ₂ (4 ¹ / ₂)
9. Interest Rates Short-term		
per cent		
1983-84	9 ¹ / ₂	9 ¹ / ₂
1984-85	8 ¹ / ₂	10
1985-86	8	9 ¹ / ₂
1986-87	7	8 ¹ / ₂
10. Money Supply £M3		
(% change on year earlier)		
1983-84 target period	9	9 ¹ / ₂
1984-85 " "	9	9
1985-86 " "	8	7
1986-87 " "	8	6
11. Money Supply M0		
(% change on year earlier)		
1983-84 target period	6	6
1984-85 " "	6	6 ¹ / ₂
1985-86 " "	5 ¹ / ₂	5 ¹ / ₂
1986-87 " "	5 ¹ / ₂	5 ¹ / ₂

*to be reduced
to new rate
with business*

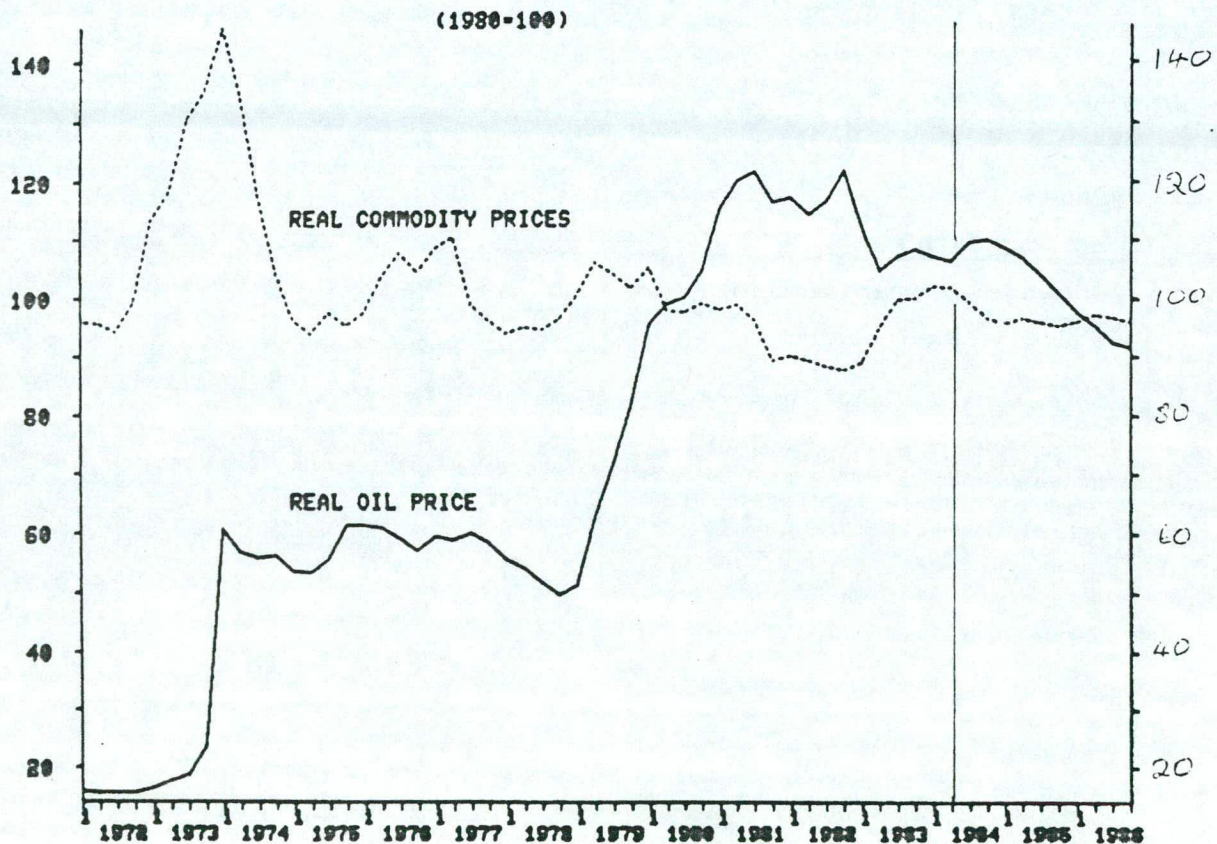
FORECAST REPORT: DETAILED SECTIONS

The world economy

1984 is turning out the best year for growth in world output and trade since 1976. In the United States total output this year may be 7 per cent or more above 1983 levels, domestic demand 9 per cent up and total imports up over 25 per cent. Elsewhere, tighter fiscal policies and efforts to bring down inflation are contributing to more modest growth in domestic demand and output.

This very rapid expansion in the US has so far had little impact on world inflation. Commodity prices did pick up sharply in the course of 1983 as expectations of recovery were finally confirmed, but have recently fallen back some way: perhaps because many producers are under financial pressures to maximise revenues and output, and because in the industrial countries restocking has been modest. Oil prices, set in dollars, have strengthened in real terms since mid 1983 as the dollar has risen, but with continuing pressures from many suppliers for higher output, we expect falls in real oil prices: this could come about, as in the forecast, by a combination of stable dollar oil prices and (from mid 1985) a falling dollar; or if the dollar were to stay very high, by cuts in dollar oil prices.

COMMODITY PRICES



SECRET AND PERSONAL

Inflationary pressures in the industrialised countries have also been very subdued. In the US, the rising dollar has taken perhaps 1-2 per cent a year off inflation rates since 1982; while domestic wages have so far responded very little to the fall in unemployment. Outside the US, there has been progress towards lower inflation in Europe, despite falls in exchange rates.

The US economy seems set for slower growth; already foreshadowed in the leading indicators. The main factor is a lower growth of domestic demand, especially in interest-sensitive areas such as stockbuilding, housing investment and consumer durables. Assuming only very slow progress in reducing the fiscal deficit, and a slow pick up in inflation - particularly once the dollar begins to fall - we expect US interest rates to stay high through 1985 and 1986. We have assumed that US residents and foreigners continue to fund the deficits, without any major break in confidence. The difficulty here is that although the US policy imbalance is not sustainable indefinitely, its resolution could well take several years.

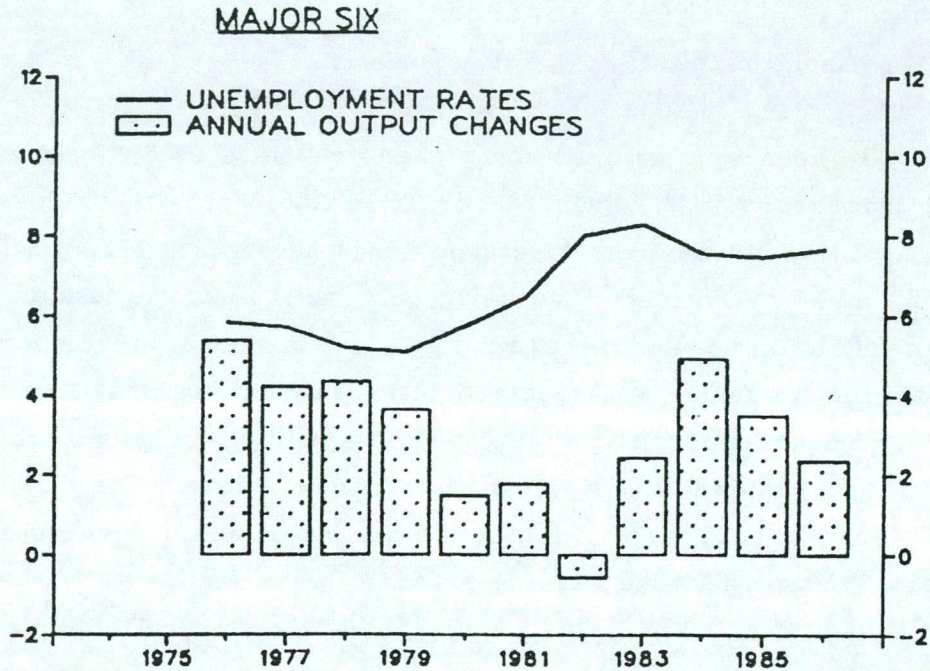
By 1986 the US could be in recession again. In Europe the recovery has not yet gone very far and a growth rate of 3 per cent or so could well be sustained in 1985 and 1986. In the developing countries, growth of domestic demand and imports may continue to be subdued for a time, with major adjustment problems remaining; and OPEC markets, reflecting low oil production and renewed falls in oil prices, are also liable to be weak.

Overall, the slowdown in the US will probably not be fully offset by higher growth elsewhere. Nevertheless 1985 and 1986 could well be years of reasonable growth and low inflation:

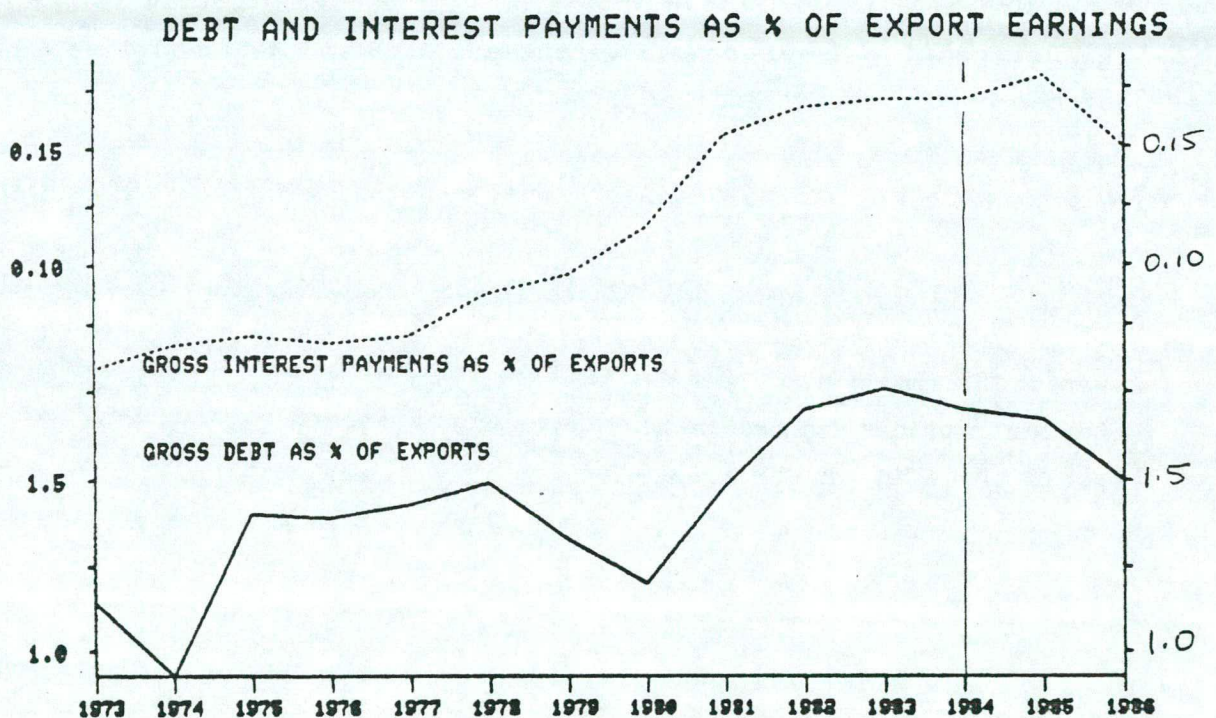
per cent changes on a year earlier

	1983	1984	1985	1986
World GNP (major 6)	2 $\frac{1}{2}$	5	3 $\frac{1}{2}$	2 $\frac{1}{2}$
Consumer prices (major 6)	4 $\frac{1}{2}$	4 $\frac{1}{2}$	4	4 $\frac{1}{2}$
World trade in manufactures (UK-weighted)	1 $\frac{1}{2}$	7	4 $\frac{1}{2}$	4 $\frac{1}{2}$

This forecast of slowing growth suggests - in the absence of major changes in labour market behaviour - that the fall in unemployment (almost exclusively in North America) will soon be over:



An implication of this forecast for the major debtor countries is that 1985 is likely to be another difficult year: continuing very high US interest rates, with a high dollar and low commodity prices, may offset the extra earnings from continued expansion of world trade. Beyond 1985, the prospects look rather better, even taking account of some slowdown in the growth of world trade:



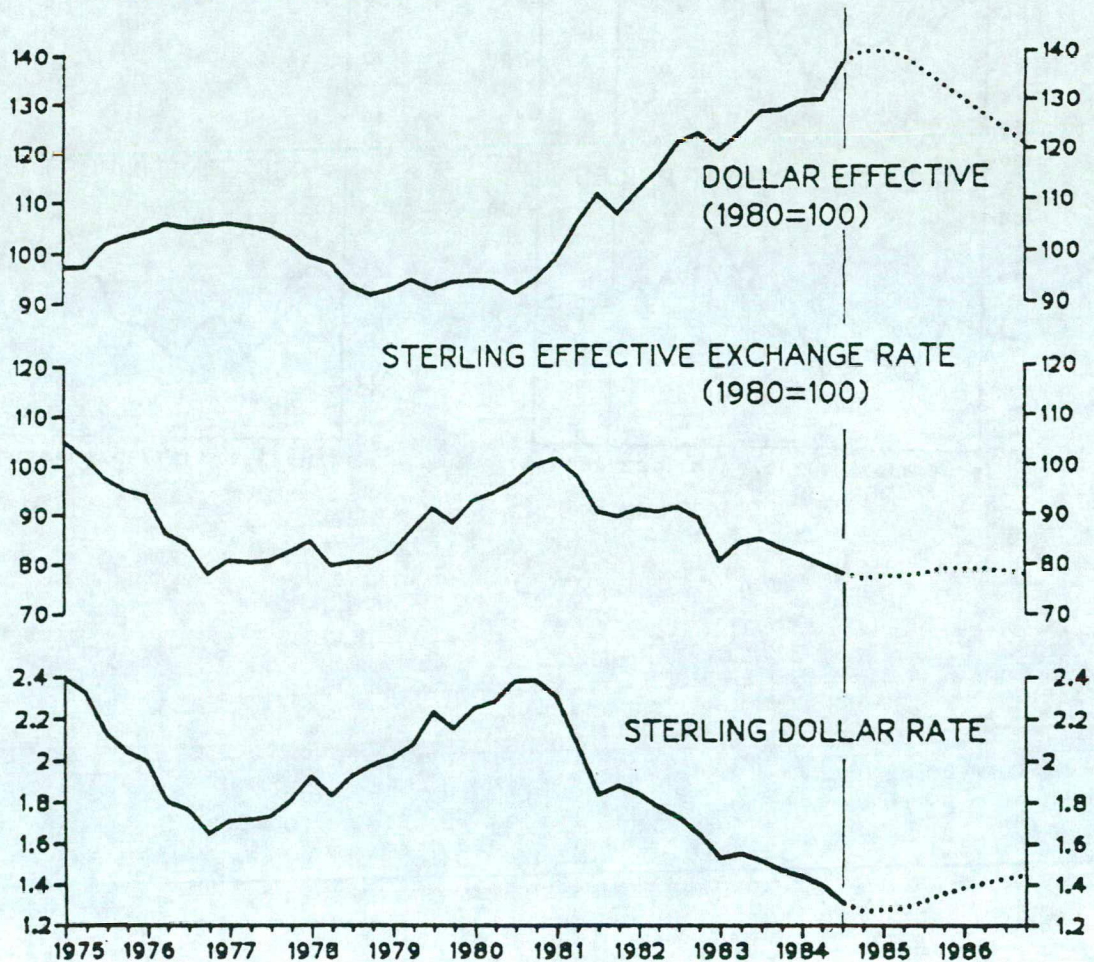
SECRET AND PERSONAL

The Exchange Rate and competitiveness

From its peak in the first quarter of 1981 sterling's effective exchange rate has fallen by about a quarter. The rate of depreciation against the dollar has been over twice as great.

Over the forecast period, by contrast, we see a period of relative stability in the effective rate. There may even be some slight appreciation when the miners' strike ends and the dollar falls. The market's expectation implicit in current forward exchange rates is for a small fall in sterling: we think this is because the market is too pessimistic on the prospects for domestic inflation. Current account surpluses - in reality if not in the first CSO estimates - through 1985 and perhaps 1986 also point to some stability in the exchange rate. In the medium term, however, if North Sea oil production falls away as forecast by the Department of Energy and world oil prices weaken, the worsening current account surplus may lead to a weaker exchange rate. We have assumed that the current level of the rate makes only a partial allowance for this.

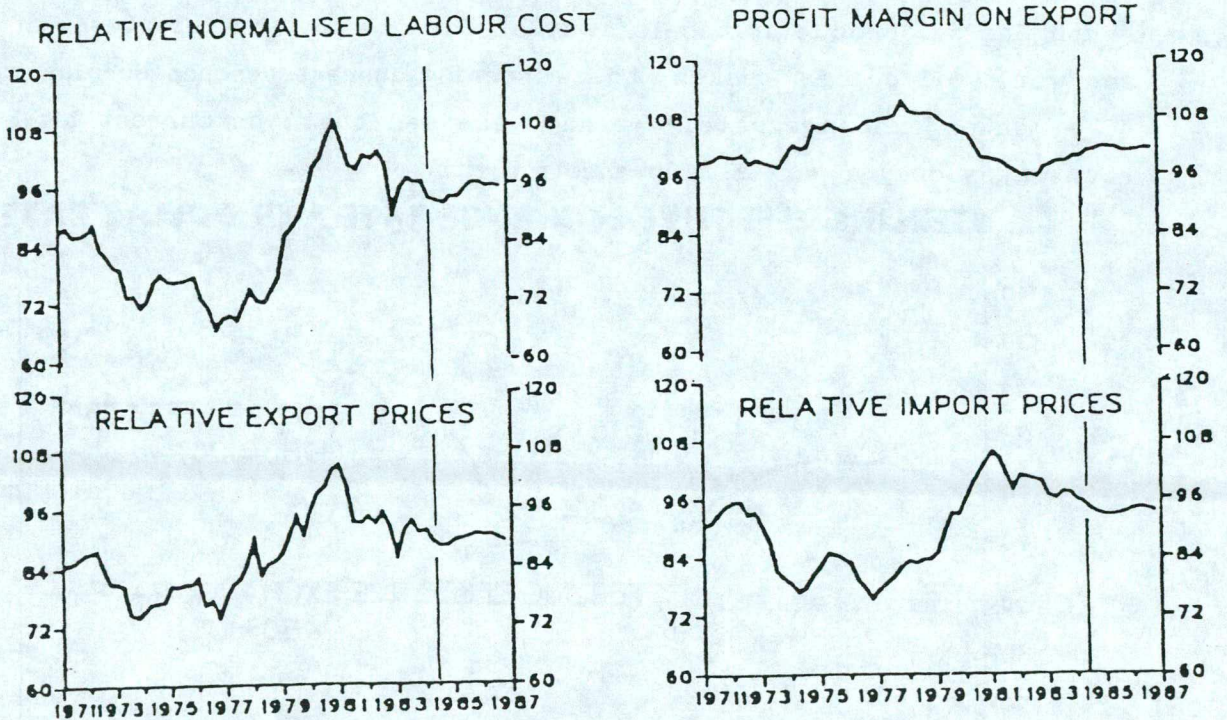
STERLING EFFECTIVE EXCHANGE RATE AND DOLLAR RATE



Between the first quarter of 1981 and the fourth quarter of this year, the competitiveness of UK manufacturing, measured by relative normalised and unit labour costs, has improved by some 20 per cent. This is less than the fall in the effective exchange rate with the gap being accounted for by UK unit labour costs growing faster than those of our competitors, because of faster earnings growth in the UK.

The temporary strengthening of sterling foreseen in the forecast, together with a projection of UK unit labour costs which continue to grow 2-2½ per cent faster than those of our competitors, suggests that the recent period of improving cost competitiveness in manufacturing may be partly reversed over the next two years. Profit margins on exports reach their peak about now and may worsen slightly next year.

COMPETITIVENESS OF MANUFACTURES, 1980=100



SECRET AND PERSONAL

Trade and the balance of payments

The stability of the exchange rate leads to a rapid slowdown in import price inflation, which for manufactures falls to annual rates of 5 per cent in the year to 1985 Q4, and 4¹/₂ per cent in the following year, after reaching 10¹/₂ per cent this year. This is broadly in line with world wholesale price inflation, put at 4 per cent over the forecast period, and implies that import price competitiveness for manufactures, which has been improving at 3¹/₂ per annum since the start of 1981, may now stabilise. Commodity prices (see page 11) may be fairly depressed over the next year or so.

This slowdown in import price inflation plays an important role in keeping domestic inflation low over the next two years, and in maintaining our terms of trade close to current levels.

The miners' strike has raised oil imports this year. Current estimates, assuming little further increase in oil burning at power stations, suggest that the net effect on the balance of payments of the strike will be around £2 billion. However, the forecast for the oil balance this year is little changed from the FSBR, since the higher sterling oil prices and higher level of North Sea oil production broadly offset the effects of the strike. In 1985, the oil balance recovers from the effects of the strike and peaks at £10 billion, £3 billion higher than assumed in the FSBR. Further details on oil are described in detail in the separate report by Mr Hacche.

Statistics of non-oil trade volumes have been distorted by the July dock strike but underlying trends have been for slower growth in both exports and imports.

For 1985 and 1986, we expect exports of manufactures to grow, as usual, rather more slowly than world trade. By 1986 competitiveness movements may be having an adverse effect. Other non-fuel exports should continue to do well, helped by this year's good harvest.

Manufacturing exports

per cent change on previous year in:

	World Trade (- signifies improvement)	Cost Competitiveness	Export Volumes: Manufactures	Food and basic materials
1982	-2 ¹ / ₂	-1 ¹ / ₂	1	0
1983	1 ¹ / ₂	-7	-2	4 ¹ / ₂
1984	7	-1 ¹ / ₂	7 ¹ / ₂	6 ¹ / ₂
1985	4 ¹ / ₂	1	3 ¹ / ₂	3 ¹ / ₂
1986	4 ¹ / ₂	1 ¹ / ₂	2 ¹ / ₂	4 ¹ / ₂

Trends in import penetration have varied from sector to sector, with rapid increases in manufacturing being offset by falls in fuel imports as North Sea oil production has risen. We expect those trends to continue over the forecast period, as domestic demand for manufactures - noticeably more cyclical than total domestic demand - continues to grow strongly. In the absence of substantial restocking by industry, imports of basic materials may not change much, and growth in food imports is also likely to be muted by growing domestic production of foodstuffs.

SECRET AND PERSONAL

percentage change on year earlier in:

	Total Domestic Demand	Domestic demand for manufactures	Imports of Manufactures (excluding erratics)	Import Price Competitiveness
1980	-3	-13	6	-11
1981	-1 ¹ / ₂	-5 ¹ / ₂	4 ¹ / ₂	2 ¹ / ₂
1982	2 ¹ / ₂	1	10	-2
1983	4 ¹ / ₂	7	11 ¹ / ₂	-3 ¹ / ₂
1984	2 ¹ / ₂	4 ¹ / ₂	10 ¹ / ₂	-2 ¹ / ₂
1985	3 ¹ / ₂	4	9	-1 ¹ / ₂
1986	3 ¹ / ₂	4	8 ¹ / ₂	1

We continue to expect the invisibles balance to improve: for 1984 we could see an eventual outturn of £4 billion following an estimated £3¹/₂ billion in 1983.

The balance on services, as a percentage of GDP, reached a low point in 1982, as the effects of our loss of competitiveness were felt, and the decline in the UK merchant fleet reduced our balance on sea transport by nearly £1 billion between 1980 and 1983. As some of this loss of competitiveness has been regained, the balance has started to recover, and with a slower decline in the UK fleet and a fairly buoyant world economy, we expect a continued improvement in the services balance over the next two years.

The balance on interest, profits and dividends (IPD) has risen from zero to £1.7 billion between 1980 and 1983, with the build up of the UK's net asset position abroad. This in turn has been made possible by the

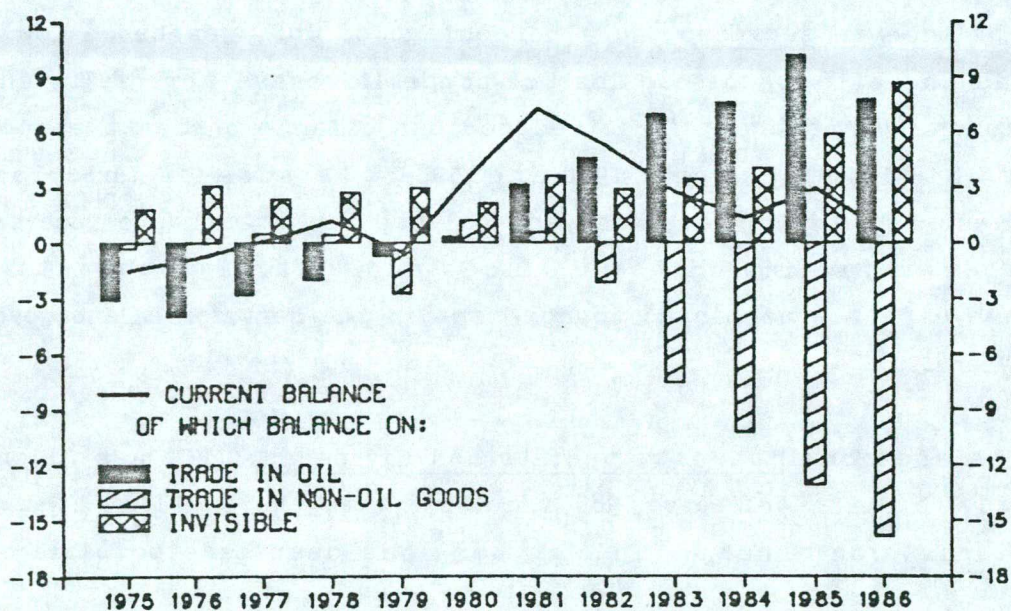
capital outflows which formed the counterpart to the large current account surpluses of the 1980-1983 period, assisted by rises in stock market prices and currency revaluations. The fall in sterling against the dollar has been particularly important in this regard since some 50 per cent of our overseas assets are denominated in dollars. With the £/\$ appreciation expected from 1985 onwards this process may reverse somewhat and the share of net assets in GDP may stabilise despite continuing capital outflows:

Net UK External Assets

End year	£ billion	per cent of GDP	£/\$ exchange rate
1979	15	7 ¹ / ₂	2.16
1983	56	18 ¹ / ₂	1.47
1986	73	19 ¹ / ₂	1.45

The overall effect of these developments on the current account is shown in the chart below:

BALANCE OF PAYMENTS CURRENT ACCOUNT (£bn)



SECRET AND PERSONAL

Our estimate of a current account surplus of £1 billion in 1984 compares with a CSO estimate of a zero balance for the first eight months. We have allowed for: EC refunds in Q4, a seasonal recovery in exports in Q4 (not captured in the seasonal adjustments); and a better outcome on invisibles than indicated by recent data and CSO projections. An improvement in the current account surplus forecast for 1985 reflects in particular lower oil imports after the assumed ending of the miners' strike, low commodity prices, and a rising surplus on invisibles.

Over recent years, the decline in the balance on non-oil visible trade, of which some 80 per cent is manufactures, has been partly offset by improvements in the oil balance. The latter trend may come to an end next year as North Sea oil production peaks, and some fall in the oil balance is likely thereafter. Past trends suggest that a further weakening of the balance in non-oil visible trade is likely, unless there are more fundamental changes in non-price aspects of competitiveness such as delivery dates, product design and quality. A rise in the invisibles surplus should provide some offset, but the run of current account surpluses between 1980 and 1985 may be followed by deficits thereafter. All such projections, however, are highly tentative: it is easier to see the broad trends of the separate components of the current account than it is to provide an accurate forecast of the net balance. The forecast is summarised in the table below:

*Labour
with?*

balances, £ billion

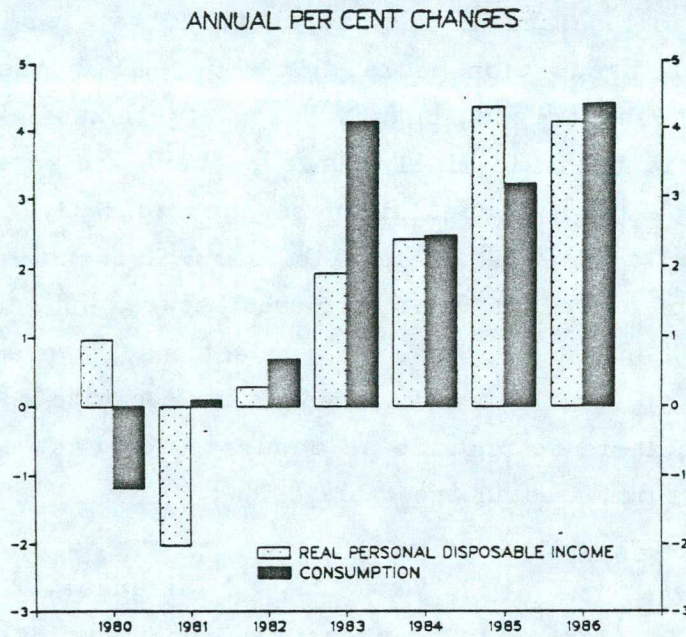
(figures in brackets are rough estimates of what the position would have been in the absence of the miners' strike)

	Oil	Other goods	Invisibles	Current account
1983	7	-7 ¹ / ₂	3 ¹ / ₂	2 ¹ / ₂
1984	7 ¹ / ₂ (9 ¹ / ₂)	-10	4	1 ¹ / ₂ (3 ¹ / ₂)
1985	10	-13	6	3
1986	7 ¹ / ₂	-16	8 ¹ / ₂	1 ¹ / ₂

SECRET AND PERSONAL

Personal income and spending

Consumer spending rose strongly to the end of 1983, with lower inflation and interest rates and easier borrowing playing a major role in the move to a lower saving ratio. From 1984 onwards however these factors are likely to be much less important, and consumer spending may grow much more in line with real incomes. These grow fairly rapidly from next year onwards, boosted by the recovery from the effects of the miners' strike and sizeable fiscal adjustments.



Real income growth can be decomposed as follows:

Annual changes: contributions to growth in real personal disposable income

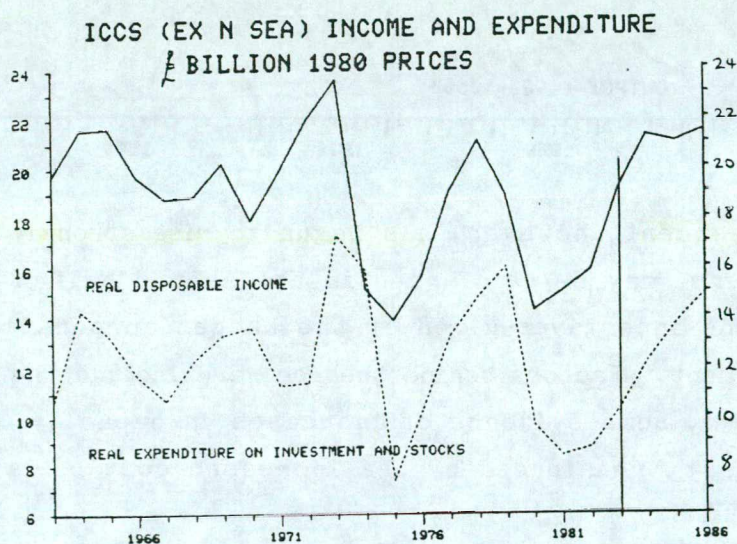
	Employment	Real Earnings	Social security etc	Property income	Fiscal adjustment	RPDI (excluding miners' strike)
1984	1/2	1	1/2	1/2	0	2 1/2 (3)*
1985	1/2	2	1/2	1/2	1	4 (3 1/2)*

Within total consumer spending, the boom in durables has levelled out; but renewed rises in real incomes and cuts in interest rates may stimulate further sizeable growth in the course of 1985 and 1986. The personal sector's investment in dwellings - nearly half on improvements - may start rising again in the course of 1985, but only after a sharp fall back in the second half of 1984 as a result of the extension of VAT to building alterations and the cutbacks in local authority grants.

All this is in terms of **flows** of income and spending. We also look at the implications for **stocks** of financial and real assets, which are affected by both flows and revaluations: there may be relatively little change in the ratio of financial assets to income and perhaps some modest increase in the total assets ratio (which takes account of a forecast rise in house prices relative to other prices).

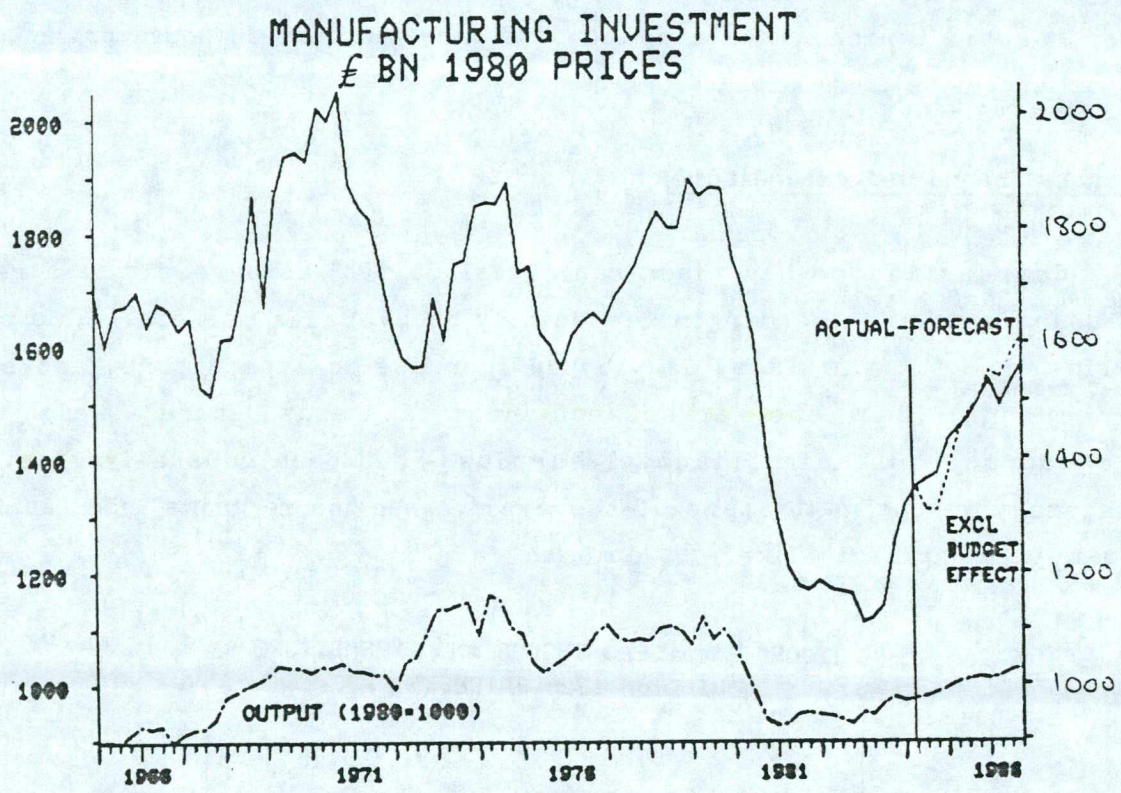
Company income and expenditure

Company income has risen rapidly since 1981 as a result of a recovery in sales and widening margins especially in overseas markets. This has been followed, with the usual lag, by an increase in expenditure, above all on investment. But the gap between income and expenditure - which broadly corresponds to their financial surplus - has been unusually wide. As is customary in the next stage of the cycle, when income grows less rapidly, the financial surplus is likely to diminish.



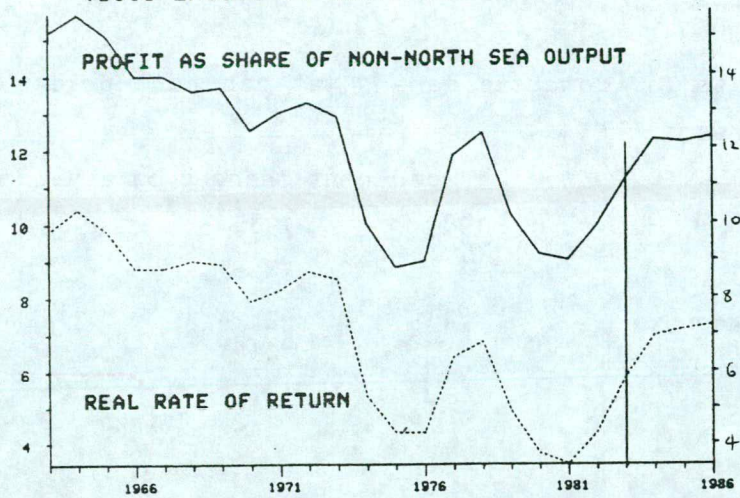
Companies have been economising, particularly in manufacturing, on stocks and employment. Stock/output ratios are continuing to fall and we do not expect any recovery: real interest rates are high, the budget changes increased the cost of holding stocks, and these factors are reflected in for example CBI enquiries showing no desire to add to stocks. Similarly on employment: in 1983 companies preferred to meet extra demand by increasing overtime rather than employment. Holding financial assets, however, has become more attractive with high real interest rates, and with over two-thirds of ICC sight deposits now bearing interest compared to a much smaller percentage five years ago the cost of holding liquidity has fallen to low levels.

Handwritten notes:
1
1983



Fixed investment, however, has begun to rise strongly. In manufacturing a cyclical upturn may be reinforced in the second half of this year and into next year by the incentives given by the budget corporation tax changes to advance investment. Factors behind the recovery include the higher prospective rates of return, some evidence of increases in capacity utilisation, and a continuing quest, reinforced by the increased cost of labour, for greater efficiency.

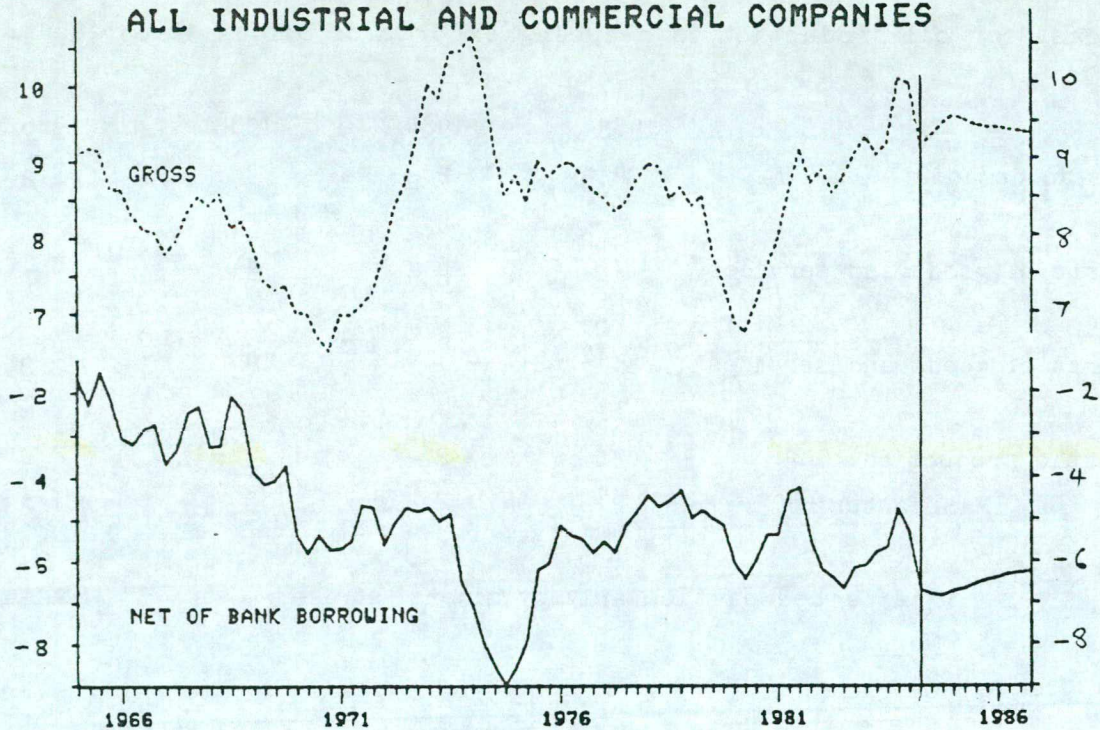
PROFIT SHARES AND REAL RATE OF RETURN (PER CENT)
(ICCS EXCLUDING NORTH SEA COMPANIES)



The persistence of high real interest rates poses some risks to the forecast of company expenditure. But the strong recovery in company finances and profitability goes the other way. The forecast shows an unusually low rate of stockbuilding, but a strong growth in investment: a change in this mix would not have much influence on the short-term outlook.

Liquidity ratios continue to look comfortable:

LIQUIDITY RATIOS (PER CENT)
ALL INDUSTRIAL AND COMMERCIAL COMPANIES



SECRET AND PERSONAL

Demand and activity (summary)

The prospects for domestic demand (at constant prices) are summarised in the table below:

	per cent changes on a year earlier			
	1983	1984	1985	1986
Personal consumption	4 ¹ / ₂	2	3 ¹ / ₂	4
Public consumption	2 ¹ / ₂	1 ¹ / ₂	1 ₂	-1 ₂
Public investment	12 ¹ / ₂	2	-4 ¹ / ₂	-2 ¹ / ₂
Private investment	1 ¹ / ₂	9	3 ¹ / ₂	6 ¹ / ₂
Change in stockbuilding* (as per cent of level of GDP)	1 ₂	-1 ₂	1	0
Total domestic demand	4¹/₂	2¹/₂	3¹/₂	3¹/₂

The growth in exports forecast for 1985 and 1986, and continued growth in domestic demand, should produce further output gains. By 1986 the fall forecast for oil production is reducing exports of oil by 10 per cent.

	1983	1984	1985	1986
Domestic demand	4 ¹ / ₂	2 ¹ / ₂	3 ¹ / ₂	3 ¹ / ₂
Exports of goods and services	1	6	4	2
Imports of goods and services*	5 ¹ / ₂	7	4	5 ¹ / ₂
Domestic production: GDP	3	2¹/₂	3¹/₂	2
Manufacturing	2 ¹ / ₂	2	3	1 ¹ / ₂

*Affected particularly by miners' strike

SECRET AND PERSONAL

The estimated effects of the miners' dispute and of North Sea oil and gas production on total GDP can be seen in the following table:

1980 = 100, and per cent changes on a year earlier

	1983	1984	1985	1986
GDP average measure	104.1 (3.2)	106.6 (2.3)	110.1 (3.3)	112.4 (2.1)
Contribution of N Sea production to GDP changes	+0.4	+0.5	0	-0.7
Effects of miners' strike on GDP changes	0	-1.1	+1.1	0
GDP <u>less</u> contribution of both oil and miners' strike	2.8	2.9	2.2	2.8

The growth of oil production has accounted for half a per cent a year of the growth of GDP for the last four years but a forecast contraction (now deferred until 1986) is expected to reduce growth. It should, however, be recognised that future levels of oil production are particularly uncertain.

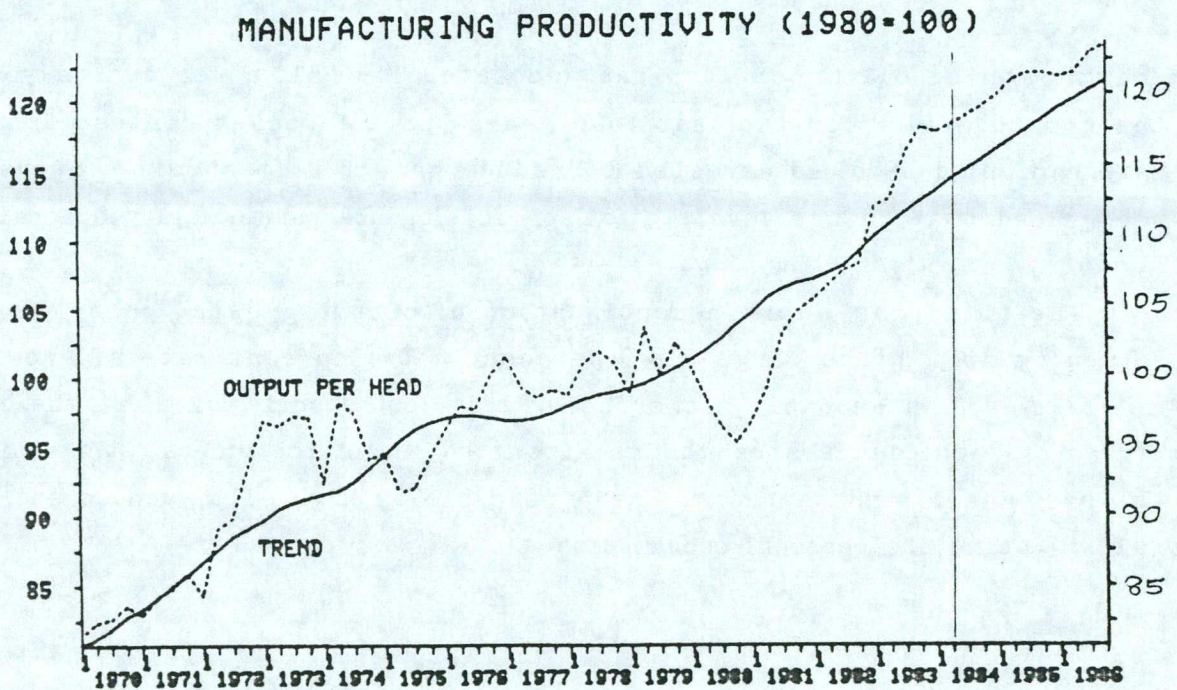
The final row shows a continuation of output growth, underlying and excluding oil, in the range 2¹/₂-3 per cent. The current rate of growth in mid/late 1984 is probably rather below this, but should pick up in the course of 1985 as confidence strengthens after the end of the miners' strike, interest rates fall, and tax cuts - made possible by high oil revenues and asset sales - stimulate personal consumption.

Productivity and the labour market

The rise in unemployment since mid 1980 has been much faster than expected, and it has gone on longer than expected. For much of the period, productivity growth was well above the (low) rates in the 1970s, as employment - above all in manufacturing - fell rapidly. More recently, since early 1983 the rise in employment seems to have been met mainly by people drawn into the labour force or by reductions in non-claimant unemployment and not at all by a fall in claimant unemployment which continues to rise. This section looks at these trends in more detail.

Productivity (output per head)

The erratic movements in output per head in manufacturing are shown in the chart below. Cyclical changes - reflecting changes in expectations of demand, adjustment lags etc - are marked, and extremely difficult to distinguish from longer-term trends.



SECRET AND PERSONAL

The contrast between different periods is set out in the next table. Actual productivity changes, even over complete cycles, can be affected by the strength of the boom/recession: thus the 1973 peak in activity was an exceptionally strong one, certainly in relation to 1979, and employers did not adjust their labour forces in full (correctly, as it turned out). Making allowance as best we can suggests that the slowdown in underlying productivity growth in the 1973-79 period was not as marked as in the raw figures. A similar problem makes the estimate of trend productivity growth in the 1979-83 period difficult.

per cent changes in output per employee,
annual averages

	Manufacturing		Non-manufacturing	
	Actual	Underlying	Actual	Underlying
1964-73	4	3	3 ¹ / ₂	
1973-79	3 ₄	13 ₄	1 ₄	not
1979-83	3	23 ₄	1	available
<u>Forecast</u>				
1983-86	2 ¹ / ₄	2 ¹ / ₂	1 ¹ / ₄	

In manufacturing and to a lesser extent non-manufacturing, 1979-83 was made up of two distinct periods in which productivity at first fell and then recovered strongly. An average over the four years seems the best way of eliminating cyclical influences and this suggests an improvement in trend since the late 70s. Recent work in the Treasury suggests that much of the difference between the underlying trends in the 70s and 80s can be explained by movements in the factor prices of labour, capital, and materials. It may be that since 1980 changes in working practices and attitudes to innovation have had a permanent effect on the rate of growth of productivity: the evidence seems inconclusive. We are projecting trends that are higher than the 70s but, for manufacturing, not quite as high as in the 1979-83 period.

Employment, labour supply and unemployment

Recent changes are estimated as follows (the numbers are dependent on DE's allowances for under-recording, equal to almost the whole increase over the period):

	June 1983 - June 1984
Total employment change	+250
(a) of which manufacturing	-60
other	+310
(b) of which part-time women	+160
other	+90
Total unemployment (wide measure, adjusted for 1983 budget measures)	+80
Total working population	+330
Estimated effect on labour force of change in population of working age	+150

The sizeable increase in employment since early 1983, outside manufacturing, has been mainly amongst part-time women: very broadly, redundancies/job losses in manufacturing have led to more people joining the unemployment register; while the growth in employment in the service industries has been predominantly female part-timers not previously recorded as unemployed. Thus the total working population has risen sharply, even in relation to the demographic rise in the labour supply.

Handwritten notes:
 * for - multi female
 for part + 25
 (+ 5 years)

Handwritten note:
 jobs?)

Recent experience, and analysis of earlier data, suggests that a fall in employment is much more likely to be reflected in higher unemployment if the job loss is in manufacturing. In the short run (perhaps several years) economic developments which have the effect of shifting demand towards manufactures may reduce overall unemployment as measured.

In the course of 1984, the fall in manufacturing employment has almost stopped; but the rise in employment elsewhere may have slowed down: evidence comes from early indications of Q2 employment and recent rises in unemployment.

Over the forecast period, we do not see much change in manufacturing employment, but further increases elsewhere in the private sector. This allows for the productivity trends described earlier and for continuation into 1985 and 1986 of underlying growth of non-oil output of some 2¹/₂ per cent a year. With real wages continuing to rise quite substantially there is no contribution from this source to higher employment.

We suspect that the tendency for the growth in jobs to be filled by part-time women may continue into 1985. This means that, once again, we have raised the forecast of unemployment. Currently 3.1 million (UK, adult seasonally adjusted), it may rise to 3.2 million next year.

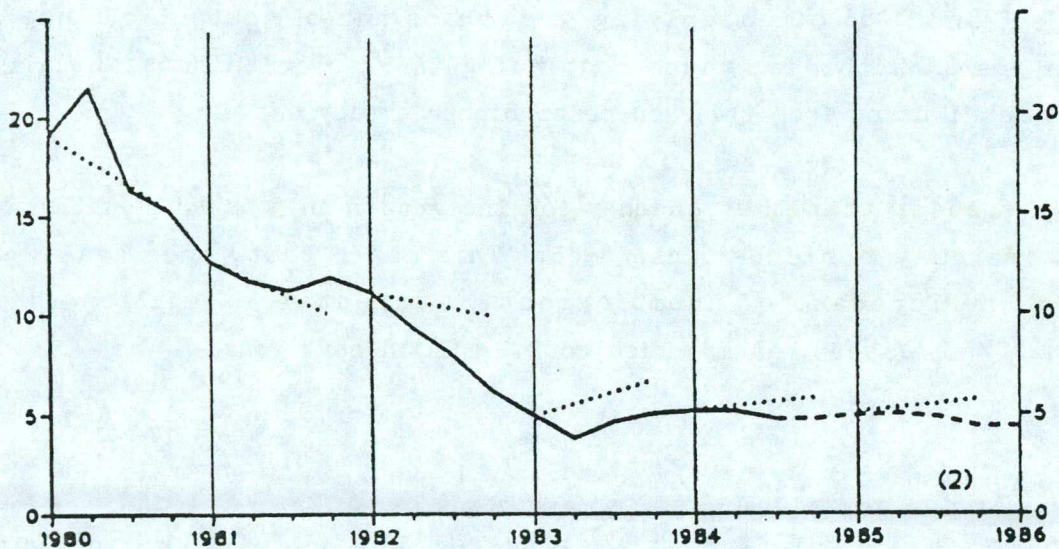
INFLATION

Prices

Inflation in 1984 is turning out much as we expected this time last year. Although sterling has fallen, inflation overseas has stayed low. Competitive pressures in the domestic market are evident from what looks like a squeeze on domestic profit margins over the last few months.

The general tendency amongst outside forecasters to overestimate price rises can be seen in the chart below. The solid line shows the path of actual/forecast inflation; and dotted lines show the in-year projections of inflation made by outside forecasters early in each year.

RPI % CHANGES ON A YEAR EARLIER : ACTUAL/HMT
FORECAST AND OUTSIDE FORECASTS



The forecast looks for some further small decline in inflation over the next two years:

	per cent changes on a year earlier	
	Retail prices	Producer prices
1984 Q4	4 ³ / ₄	5 ¹ / ₂
1985 Q4	4 ¹ / ₂	5 ¹ / ₄
1986 Q4	4	4 ¹ / ₂

SECRET AND PERSONAL

The main influences on wholesale price inflation can be seen in the table below:

per cent changes on a year earlier

	Import prices in £		Labour costs	Prices of		Level of
	Materials	Fuel	in UK (manufacturing)	of manufactures domestic*	imports (finished)	margin over current costs per cent
1982	7	13	3 ¹ / ₂	7	10	6 ¹ / ₂
1983	8	5	1	5 ¹ / ₂	11	9
1984	10	8	5	5 ¹ / ₂	7 ¹ / ₂	8 ¹ / ₂
1985	6	11	4 ¹ / ₂	5 ¹ / ₂	8	8
1986	3	-3	6	4 ¹ / ₂	4	8

*excluding food, drink & tobacco.

The competitive pressures on UK manufacturers have eased somewhat in the last two years, with a lower pound; and domestic margins (a very approximate measure of which is given in the final column) have expanded. From early 1984 a part of the faster rise in labour and some other costs have not been passed on, leaving domestic margins currently below the level in the first half of this year. We expect slightly faster monthly increases in selling prices for a time, and this, together with developing weakness in commodity prices, should allow margins to rise for a while. By late 1985 and into 1986, the steadier exchange rate and low world inflation is making for some downward trend in inflation with not much change in margins.

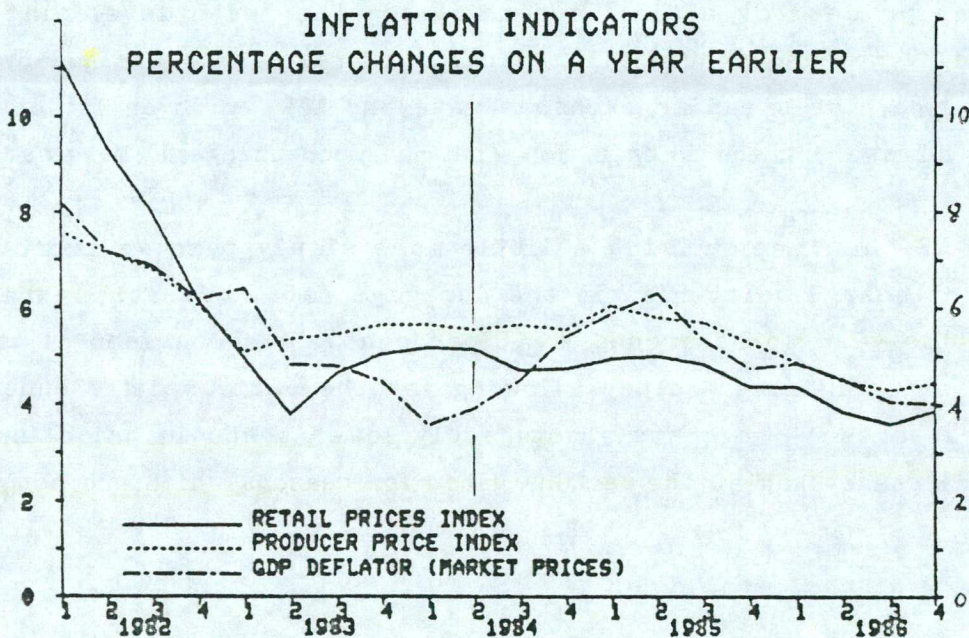
The RPI had been rising a little more slowly than we expected, until the recent near 3 point rise in the mortgage rate. We still expect the Q4 outcome this year to be around 4¹/₂-5 per cent. A comparison of the RPI and producer price indices - after allowing for the obvious differences such as housing, food etc - suggests a noticeably lower trend in price increases at the retail stage than at the factory gate, for reasons which are not clear.

SECRET AND PERSONAL

The components of the RPI, and the total, are shown in the following table (budget forecast in brackets):

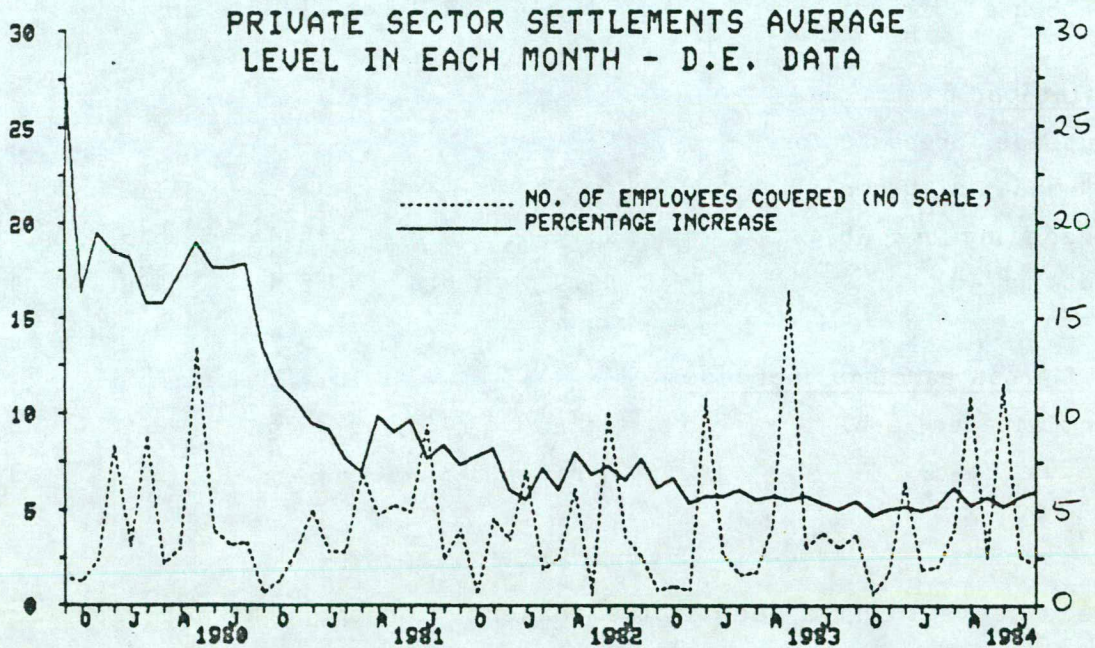
	Weights in total	per cent changes on a year earlier			
		1984	1985	1985	1986
		Q4	Q2	Q4	Q4
Food	20	3(3)	2 ¹ / ₂	3 ¹ / ₂	4 ¹ / ₂
Housing	15	11(7)	11	4	2
Nationalised industries	9	3 ¹ / ₂ (3 ¹ / ₂)	4 ¹ / ₂	5	4 ¹ / ₂
Other	56	4(4 ¹ / ₂)	4 ¹ / ₂	4 ¹ / ₂	4
Total	100	4 ¹ / ₂ -5(4 ¹ / ₂)	5(4)	4 ¹ / ₂	4

Our view of May 1985 (5 per cent) is above the Budget forecast of 4 per cent reflecting higher import prices (mainly a lower pound) and higher mortgage interest rates.



Earnings

Wage inflation has not changed much since late 1982: wage settlements have run at 5-6 per cent; and annual earnings increases have settled down into the range 7¹/₂-8 per cent. In manufacturing, earnings increases, underlying, and after allowance for changes in hours worked, have been in the range 8-9 per cent since August 1982. The chart below shows wage settlements over recent years, together with an indication of the proportions settling in each month, based on unpublished DE data.



The next table shows the development of wage settlements, earnings and inflation over the last four pay rounds. Through this period, inflation turned out lower than outside forecasts; real earnings turned out higher than expected. Wage bargainers were prepared, in the period to summer 1982, to conclude settlements that provided for earnings increases lower than the expected rise in prices. Subsequently, autumn 1982 onwards, settlements were expected to lead to earnings growth only modestly (1¹/₂-2 per cent) above the level of expected inflation. But prices again rose less than expected (see also chart on page 31).

EARNINGS, INFLATION AND ANTICIPATED REAL EARNINGS GROWTH: WHOLE ECONOMY

	percentage changes on a year earlier				
	pay rounds				
	1980-81	1981-82	1982-83	1983-84	1984-85
			outturn	Forecast	
<u>Wages</u>					
Settlements	8 ¹ / ₂	7	5 ¹ / ₂	5 ¹ / ₄	5 ¹ / ₂
Underlying average earnings increase (a)	11 ¹ / ₂	9 ¹ / ₄	7 ¹ / ₂	7 ¹ / ₂	7 ¹ / ₂
<u>Inflation</u>					
Outside forecasts for Q4 made in autumn of preceding year (b)	11.7	9.8	6.1	5 ¹ / ₂	5 ¹ / ₂
Outturn (c)	11.9	6.2	5.1	4 ³ / ₄	4 ¹ / ₂
<u>Real gross earnings increase</u>					
Anticipated (a-b)	- ¹ / ₄	- ¹ / ₂	+1 ¹ / ₂	+2	2
Actual (a-c)	- ¹ / ₂	+3	+2 ¹ / ₂	+3	3

There seems to have been little tendency for these higher real earnings to be reflected in lower settlements in the next pay round: partly because the productivity improvements associated with these movements in real wages were larger than expected. Other factors included cuts in NIS and improvements in the terms of trade. Thus by the end of each pay round, although prices had risen more slowly, and real earnings faster, than expected, neither employers nor employees had any strong incentive to renegotiate. The losers, who included the unemployed, did not play much or any part in the wage negotiations. On this reading of the period, the bias in expectations of inflation has been important.

SECRET AND PERSONAL

With price inflation not changing much, we are not expecting much change in wage settlements or earnings growth over the next year or so. This would probably produce rises in real take home pay of some 4 per cent over the next year, helped by the assumed fiscal adjustment in the 1985 Budget. Companies too should see some real increase in their incomes. By 1986, the combination of slower productivity growth, slightly less inflation in 1985, and the continuing impact of the (assumed) tax reductions points to a somewhat lower trend in earnings growth.

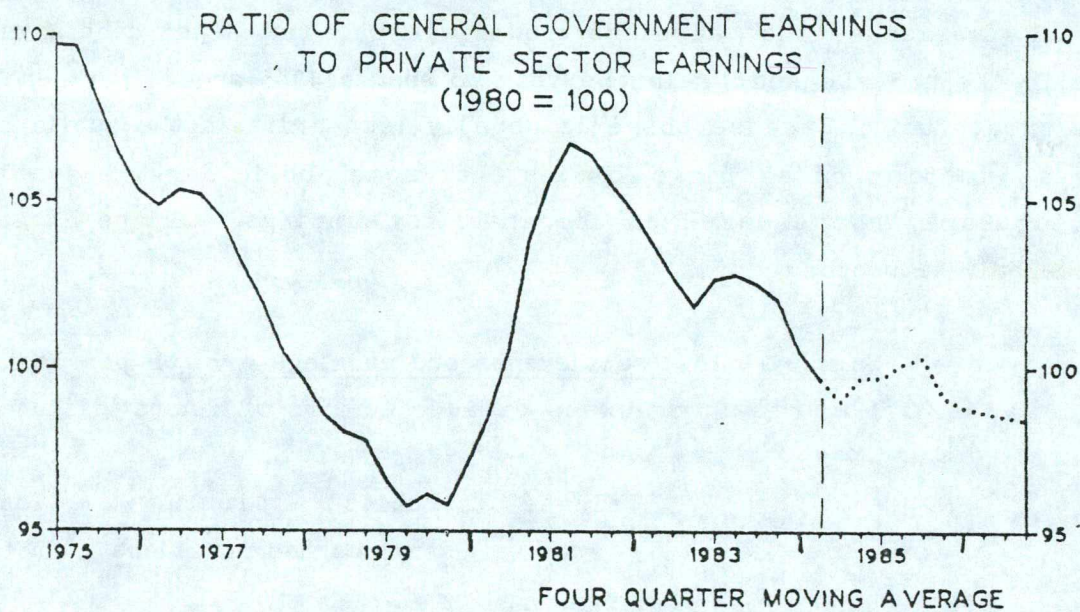
Our basic judgments relate to private sector earnings. We assume employees in nationalised industries get the same increases. For public services we assume that earnings growth will be about 1 per cent a year less than in the private sector in the year to summer 1985 and $\frac{1}{2}$ per cent a year less thereafter. Because there is usually less drift in the public services this assumption on earnings implies that some public service settlements (particularly those based on comparability findings) will be higher than in the private sector.

Summary table: settlements and earnings growth per cent
(figures in brackets exclude effects of miners' dispute)

	Private sector	Public services	Public corporations	Total Actual
pay rounds (September-August):				
	<u>settlements</u>			
1983-84	5 $\frac{1}{4}$	5 $\frac{1}{2}$	5	5 $\frac{1}{4}$
1984-85	5 $\frac{1}{2}$	5 $\frac{1}{2}$	5 $\frac{1}{2}$	5 $\frac{1}{2}$
1985-86	5	5	5	5
financial years: <u>earnings</u>				
	<u>growth</u> on previous year			
1983-84	8 $\frac{1}{2}$	6	7 (7 $\frac{1}{2}$)	7 $\frac{1}{2}$
1984-85	8	7 (6 $\frac{1}{2}$)	7 $\frac{1}{2}$ (7 $\frac{1}{2}$)	7 (7 $\frac{1}{2}$)
1985-86	7 $\frac{1}{2}$	6 (6 $\frac{1}{2}$)	6 (7 $\frac{1}{2}$)	7 $\frac{1}{2}$ (7)
1986-87	6 $\frac{1}{2}$	6	6 $\frac{1}{2}$	6 $\frac{1}{2}$

The settlements in one pay round eg 1983-84 are mainly reflected in earnings growth in the next financial year eg 1984-85. This is mainly because many settlements take place in the period March-July.

The relationship between earnings in the public services (general government) and in the private sector is shown in the following chart. A continuing, but slow, downward trend is forecast; even though earnings growth in public services is forecast well above the "pay factor".



Inflation: comparison with other countries

The inflation rate in the UK is running well above the levels in Germany and Japan, above the US, and below France and Italy. The overall average for other countries gives an inflation rate close to the UK's. But there is a clear tendency for real wages to rise faster in the UK in manufacturing, despite the contraction in output and employment in this sector being bigger in the UK than elsewhere.

percentage changes between 1983 and 1984 (part forecast)

	Consumer (retail) prices	Earnings in Manufacturing	Wholesale prices of manufactures
US	4	3 ¹ / ₂	2 ¹ / ₂
Germany	2 ¹ / ₂	2 ¹ / ₂	3
Japan	2 ¹ / ₂	6 ¹ / ₂	1 ¹ / ₂
France	8	8	13
Italy	10 ¹ / ₂	13	10 ¹ / ₂
Canada	4 ¹ / ₂	6	4 ¹ / ₂
Average of major 6	4 ¹ / ₂	5 ¹ / ₂	4 ¹ / ₂
UK	5	8 ¹ / ₂	6
Gap between UK and major 6	1 ¹ / ₂	3	1 ¹ / ₂

SECRET AND PERSONAL

Why so name?

Financial Forecast

US interest rates have eased in recent weeks following a rise in mid-summer. We see little scope for further easing in the near future and the recent falls may even be reversed. If the Fed keeps a fairly tight rein on the growth of the monetary aggregates and there is no action to cut the Federal deficit other than the down-payment, US interest rates may remain close to current levels throughout the next year and possibly also in 1986.

The FSBR forecast, in particular, under-estimated the upward pressures on UK short-term interest rates. This was partly because US interest rates have been firmer, partly because the dollar has been stronger for given US interest rates. The upward pressure on UK rates in July had domestic as well as external origins, in particular market worries about the industrial situation and some aspects of domestic monetary conditions. As seemed likely at the time however some of these worries were short-lived and the rise in rates in July has been partially reversed.

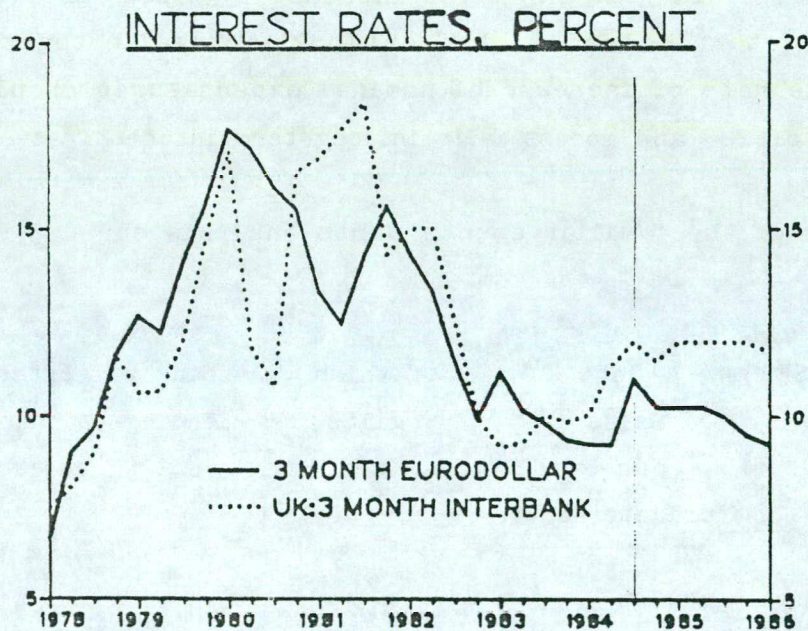
Our earlier interest rate forecasts assumed that an adverse differential between sterling and dollar interest rates could be sustained if the prospects for domestic inflation and monetary growth were satisfactory and the market expectation was for a fall in the dollar. We continue to give weight to domestic factors but these alone may be insufficient to induce a significant downward move in interest rates until the dollar and/or dollar interest rates start to weaken. The forecast, summarised below, sees a small fall in interest rates over the next year to a level somewhat below market expectations as embodied in the money market yield curve. It is also consistent, in our judgment, with growth of both main monetary aggregates within the target ranges.

L Au \$?

	3-month Eurodollars	UK short-term (3-month interbank)	UK long-term (20 year gilt)	Mortgage Rate
1983 Q4	9 ³ / ₄	9 ¹ / ₄	10 ¹ / ₂	11 ¹ / ₄
1984 Q4	11 ¹ / ₂	10 ¹ / ₄	10 ¹ / ₂	12 ³ / ₄
1985 Q4	12	9 ¹ / ₂	9 ¹ / ₂	11 ¹ / ₂
1986 Q4	11 ¹ / ₂	8 ¹ / ₂	9	10 ¹ / ₂

The mortgage rate shown in the table is that now used in constructing the RPI, that is the average rate rather than the BSA's advised rate. The forecast assumes that the societies will wish to retain most of the current competitive advantage of their investment rates in order to finance the demand for mortgage lending. Building societies may do little more than follow other rates down.

*See
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Monetary Aggregates

Treasury research suggests that the main influences on M0 are the level of personal incomes and short-term interest rates together with trends - mainly the increasing use of bank and building society accounts and credit cards - which encourage economies in the use of cash. Over the current target period to date M0 has grown at an annual rate of $5\frac{1}{2}$ per cent, well within its target range. While it might accelerate slightly in the second half of the year, it should grow by no more than $6\frac{1}{2}$ per cent over the target period as a whole. M0 should stay within its MTFS range in 1985-86 and beyond, despite the fall foreseen in interest rates.

While M0 is mainly held for transactions purposes, £M3 is much more a store of wealth and is therefore heavily influenced by the evolution of the financial wealth of the private sector. The rate of growth of gross financial wealth has slowed significantly over the last year. This is one reason for the modest rates of £M3 growth. These lower rates of growth of wealth should be sustained over the next year or so, if as expected the private sector reduces its financial surplus and the growth of bank lending slows a little. This year £M3 might increase by 9 per cent, within the 6-10 per cent target. Thereafter the outlook for wealth together with some slowing in the rate of increase of nominal expenditures should permit both deceleration of £M3 and modest falls in long-term interest rates.

In terms of the familiar counterparts analysis our £M3 forecast looks as follows:

	£ billions					
PSBR	Debt	(of which	Bank	External		
	Sales to	gilts)	lending	and other	£M3	
	non-bank			adjustments		
	private sector					
1983-84	9.7	12.4	(9.8)	15.4	-4.5	8.2
1984-85	8.7	9.1	(6.6)	14.2	-4.7	9.1
1985-86	7.1	7.8	(4.9)	14.2	-5.6	7.9
1986-87	7.6	7.5	(4.6)	13.4	-6.3	7.2

SECRET AND PERSONAL

The counterparts analysis emphasises, among other things, the role of gilts sales. It shows that lower £M3 growth over the next couple of years could be consistent with much lower net sales of gilts to the non-bank private sector than achieved last year and somewhat lower than the level likely to be achieved this year. This is conditional however on no major pick-up in bank lending and on a declining PSBR. We have allowed for increased asset sales (compared with 1983-84) to reduce a little the desire of the market to absorb gilts.

The figure for gilts in the counterparts table understates the total funding requirement because they are net sales to the non-bank private sector and do not allow either for redemptions or for sales to other sectors. The table below summarises the complete picture. This year and next the funding requirement is put at £1 billion gross sales a month but it could rise in 1986-87 with larger redemptions.

	Net sales to:		Redemptions	£ billion
	Non-bank private	Overseas and banks		Gross
				Sales
1983-84	9.8	1.8	3.7	15.3
1984-85	6.6	1.2	4.2	12.0
1985-86	4.9	1.2	6.1	12.2
1986-87	4.6	0.9	9.1	14.6

Over the last year or so, mainly as a result of the building societies increasing their share of the personal saving market at the expense of the banks, PSL2 has grown significantly faster than £M3. We expect this trend to continue for some time as there is still much unfilled demand for mortgages. In addition to the societies' gain in market share, another factor tending to increase PSL2 relative to £M3, both now and over the next two years, is the replacement of maturing building society term shares, which do not count as PSL2, by instruments which are within PSL2. (This could add over $\frac{1}{2}$ per cent a year).

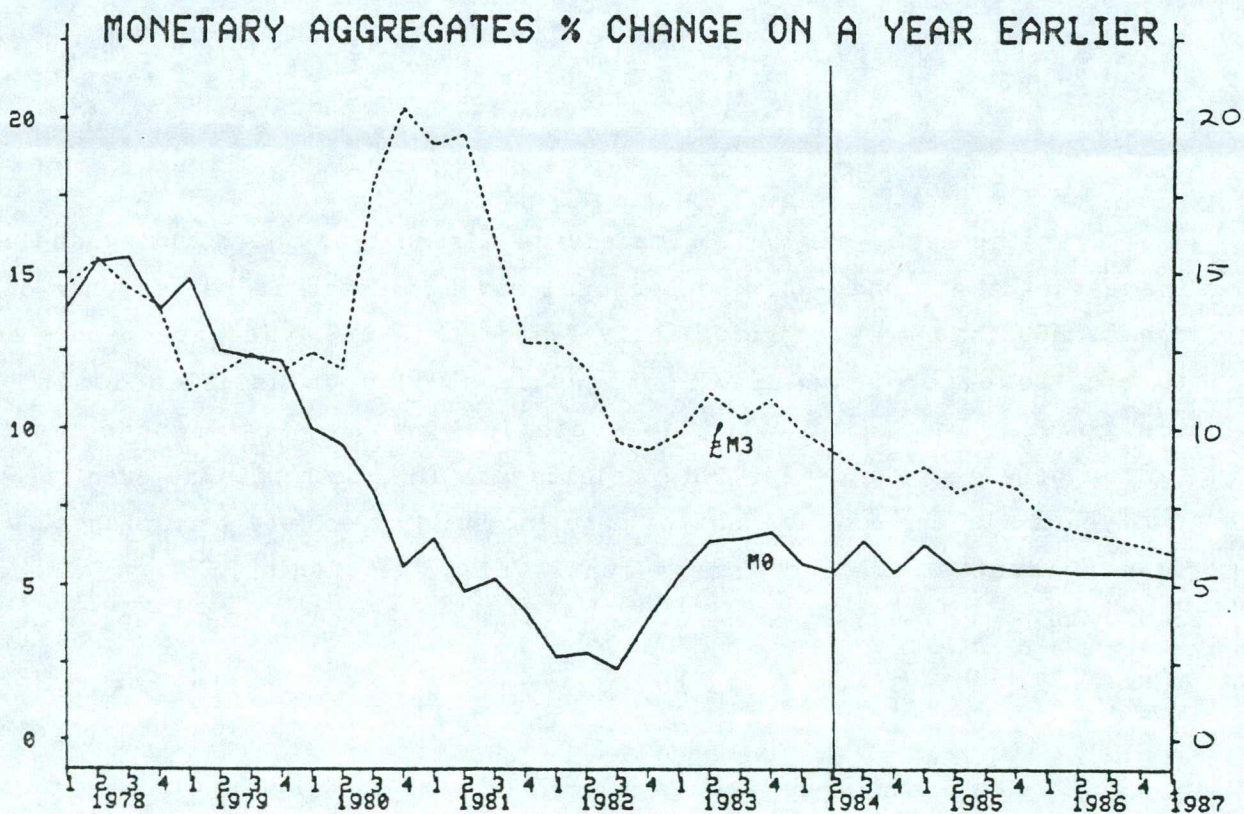
M2 growth may stay around 10 per cent, close to current rates of growth if reclassifications are excluded. Much of M2 (and M0) is held by the personal sector, which is expected to be in substantial financial surplus, helped by the assumed fiscal adjustments on income tax.

The forecast of the monetary aggregates is summarised in the following table:

*Some target for M0
2-7 M3 !!*

Target periods	M0		£M3		M2	PSL2
	Target	Outturn/ Forecast	Target	Outturn/ Forecast		
1982-83	-	4 ¹ / ₂	8-12	11	9 ¹ / ₂ *	11 ¹ / ₂
1983-84	-	6	7-11	9 ¹ / ₂	10 ¹ / ₂ *	13
1984-85	4-8	6 ¹ / ₂	6-10	9	10 ¹ / ₂	13
1985-86	3-7	5 ¹ / ₂	5-9	7	10 ¹ / ₂	11 ¹ / ₂
1986-87	2-6	5 ¹ / ₂	4-8	6	10	10 ¹ / ₂

*April-April



ANNEX, COMPARISON OF FORECASTS

Treasury Forecasts

1. Table A compares the current Treasury forecast with the last three published forecasts and the June forecast.
2. The outlook for GNP growth this year is half a per cent lower than in the previous forecast as a result of the continuation of the miners' strike. Next years's forecast growth is higher by almost the same amount because of the recovery from the strike affected level.
3. Interest rates are now expected to be rather higher and the exchange rate lower. These changes cause fractionally higher RPI inflation both this year and next.

Outside Forecasts

4. Table B compares the Treasury forecast with an average of outside forecasts. The estimate for GNP growth this year is low compared to the average of outside forecasts but 1985 growth is at the top of the range. Some differences will stem from different assumptions about the miners' strike and about fiscal policy next year. The Treasury forecast for the growth of real personal disposable income next year is higher than that of all outside forecasters partly because of the recovery from strike effects and partly because of the effect of the fiscal adjustment.
5. The RPI inflation forecast is once again below all others in both years (except Liverpool whose forecasts are annual and so not shown).

TABLE A

COMPARISON OF TREASURY FORECASTS

	1983 FSBR/MTFS	1983 A.S.	1984 FSBR/MTFS	June 1984 Forecast	September 1984 Forecast
<u>Money Supply £M3</u> (% change on year earlier)					
1983 Q1	9.7	10.2	11.0	11.0	13.3
1984 Q1	9.0	9.9	9.5	9.5	8.6
1985 Q1	8.8	9.2	9.2	8.1	8.8
1986 Q1	7.5	8.0	8.2	7.0	7.0
1987 Q1	6.1	5.4	7.9	6.3	6.0
<u>PSBR</u> £ billion (% of money GDP)					
1982-83	7.5 (2.7)	9.2 (3.3)	9.2 (3.3)	8.9 (3.1)	8.9 (3.1)
1983-84	8.2 (2.8)	10.2 (3.4)	10.0 (3.3)	9.7 (3.2)	9.7 (3.2)
1984-85	8.9 (2.5)	8.1 (2.5)	7.2 (2.2)	6.2 (1.9)	8.7 (2.7)
1985-86	7.0 (2.0)	7.0 (2.0)	7.0 (2.0)	7.0 (2.0)	7.1 (2.0)
1986-87	6.4 (1.8)	5.6 (1.5)	6.8 (1.9)	7.2 (1.9)	7.6 (2.0)
<u>Fiscal Adjustments (£ billion)*</u>					
1982-83	-	-	-	-	-
1983-84	-	-	-	-	-
1984-85	-0.4	0.5	-	-	-
1985-86	-3.8	-3.8	-1.9	-0.8	-3.3
1986-87	-8.8	-6.6	-6.8	-4.1	-7.7
<u>Nominal GDP (mp)</u> (% change on year earlier)					
1982	8.8	9.3	9.5	9.5	9.7
1983	7.5	8.4	8.6	8.6	8.5
1984	8.6	8.0	8.1	7.3	6.6
1985	7.9	7.6	6.9	7.7	9.1
1986	6.9	7.0	6.1	6.2	6.8
<u>RPI</u> (% change on year earlier)					
1982 Q4	6.2	6.2	6.2	6.2	6.2
1983 Q4	5.8	5.2	5.0	5.0	5.0
1984 Q4	5.4	4.2	4.3	4.5	4.7
1985 Q4	5.2	4.6	4	4.3	4.4
1986 Q4	5.1	4.9	4.5	4.7	3.9

* A negative sign indicates a reduction in taxation

SECRET AND PERSONAL

	1983 FSBR/MTFS	1983 A.S.	1984 FSBR/MTFS	June 1984 FORECAST	September 1984 Forecast
<u>Labour Cost Competitiveness</u>					
(Ratio of UK to competitors costs 1975 = 100) **					
1982 Q4	132.2	98.5	102.9	99.5	100.0
1983 Q4	121.0	91.0	98.5	95.2	96.3
1984 Q4	121.0	90.5	98.2	93.9	92.0
1985 Q4	118.6	92.1	97.1	95.4	96.3
1986 Q4	115.6	92.6	93.5	93.4	95.2
<u>Current Balance (£ billion)</u>					
1982	4.0	5.4	5.5	5.8	5.2
1983	1.5	0.6	2.1	2.9	2.7
1984	1.5	0.1	2.2	1.3	1.3
1985	-0.6	1.1	0.7	2.5	2.9
1986	-4.2	0.3	1.0	-0.5	0.5
<u>Manufacturing Output =</u>					
(% Change on year earlier)					
1982	-0.6	0.4	0.1	0.1	0.1
1983	1.8	1.3	1.5	1.9	2.3
1984	2.4	2.8	3.6	3.0	1.9
1985	1.9	1.4	2.1	1.7	2.8
1986	0.9	0.6	1.4	1.1	1.6
<u>GDP Volume</u>					
(% change on year earlier)					
1982	0.7	1.8	2.0	2.0	2.1
1983	2.0	2.8	2.8	3.0	3.2
1984	2.7	2.9	3.1	2.9	2.3
1985	2.4	2.8	2.5	2.9	3.3
1986	1.9	1.4	2.0	1.3	2.1

** FOR COLS 2-5 1980 = 100

SECRET AND PERSONAL.

	1983 FSBR/MTFS	1983 A.S.	1984 FSBR/MTFS	June 1984 FORECAST	September 1984 Forecast
<u>Interest Rates %</u>					
<u>Short Term</u>					
1982-83	11.3	11.5	11.5	11.5	11.5
1983-84	9.6	9.6	9.7	9.7	9.7
1984-85	7.8	8.3	8.7	9.5	10.2
1985-86	7.4	8.1	7.8	9.1	9.8
1986-87	7.4	7.6	6.8	8.1	8.7
<u>World Trade in Manufactures</u>					
<u>UK Weighted</u>					
1982	-3.3	-3.1	-2.8	-1.8	-2.6
1983	1.0	-0.7	1.3	-0.2	1.3
1984	6.6	5.3	5.1	5.4	7.0
1985	5.7	6.3	4.5	5.6	4.5
1986	2.9	4.5	4.4	4.7	4.4
<u>UK Exports of Goods and Services</u>					
<u>(% Change on year earlier)</u>					
1982	0.7	1.4	1.5	1.2	0.9
1983	0.9	0.6	0.6	0.8	1.0
1984	5.0	4.0	5.0	6.3	6.0
1985	4.9	3.9	3.9	3.7	3.9
1986	2.3	1.8	2.8	1.2	1.7
<u>Average Earnings</u>					
<u>(Private, not cyclically adjusted-</u>					
<u>% Change on year earlier)</u>					
1982 Q3	10.0	10.1	9.8	9.9	9.9
1983 Q3	7.3	8.4	8.3	7.9	8.4
1984 Q3	7.0	7.3	7.5	7.3	6.1
1985 Q3	6.5	6.4	7.3	7.5	8.7
1986 Q3	5.8	6.1	5.8	6.7	6.5

	1983 FSBR/MTFS	1983 A.S.	1984 FSBR/MTFS	June 1984 FORECAST	September 1984 Forecast
<u>Effective Exchange Rates</u> 1975 = 100					
1982	90.6	90.6	90.6	90.6	90.6
1983	80.5	83.4	83.3	83.3	83.3
1984	81.8	83.6	83.2	80.1	79.1
1985	80.8	83.0	83.5	80.7	78.0
1986	79.6	82.4	82.8	80.7	78.6
<u>Unemployment</u> (IK sa excl school leavers - millions, new definition)					
1982 Q4	2.9	2.9	2.9	2.9	2.9
1983 Q4	2.9	2.9	2.9	2.9	2.9
1984 Q4	3.0	2.9	3.0	3.1	3.1
1985 Q4	3.1	2.8	3.0	3.1	3.2
1986 Q4	3.1	2.8	3.0	3.1	3.2
<u>I & C Companies' Financial Surplus/ Deficit, £ billion</u>					
1982	1.1	2.3	2.5	3.6	4.4
1983	0.7	4.8	6.4	6.7	7.9
1984	2.3	4.6	5.1	5.4	9.3
1985	1.8	5.0	2.0	1.9	4.1
1986	0.3	3.0	- 0.3	- 1.7	2.5

TABLE B

COMPARISON WITH OUTSIDE FORECASTS

	<u>Treasury September 1984</u>	<u>Consensus</u>	<u>Low</u>	<u>Range</u>	<u>High</u>
fM3 % change in year earlier					
1984-5	8.8	8.6	8.1 (NIESR, LBS)		9.7 (Henley)
1985-6	7.0	8.5	7.0 (NIESR)		10.1 (Henley)
fM0 % change on year earlier					
1984-5	6.3	5.5	5.0 (P&D)		6.2 (LBS)
1985-6	5.5	5.5	5.1 (LBS)		5.9 (P&D)
PSBR fbn					
1984-5	8.7	7.8	7.1 (Liverpool, CBI)		10.3 (NIESR)
1985-6	7.1	7.5	5.5 (Liverpool)		10.7 (NIESR)
Exchange rate 1975=100					
1984 Q4	77.0	78.5	78.0 (Henley, S&C, P&D)		80.0 (LBS)
1985 Q4	79.0	79.7	78.0 (P&D)		82.0 (LBS)
Current account fbn					
1984	1.3	1.0	-0.2 (NIESR)		2.8 (Cambridge Econom.)
1985	2.9	1.7	-0.5 (NIESR)		3.0 (S&C)
Average earnings % change on year earlier					
1984	6.3	6.7	5.7 (S&C)		8.3 (Henley)
1985	8.0	8.1	6.6 (LBS)		9.1 (S&C)
RPI % Change on year earlier					
1984 Q4	4.7	5.3	4.8 (S&C)		5.7 (NIESR)
1985 Q5	4.4	5.8	4.9 (S&C)		6.5 (NIESR)
RPDI % change on year earlier					
1984	2.4	2.6	2.0 (LBS)		3.0 (NIESR)
1985	4.3	2.7	1.6 (LBS)		4.2 (S&C)
Import volume: goods & services % change				(Cambridge Econom.)	
1984	7.2	7.2	5.8		8.5 (NIESR, P&D)
1985	4.2	4.0	2.2 (S&C)		7.4 (Cambridge Econom.)
Export volume: goods & services % change					
1984	6.0	5.9	4.8 (Henley)		7.5 (LBS)
1985	3.9	4.4	3.5 (S&C)		5.9 (CBI)
GDP (output) volume % change					(Cambridge Econom.)
1984	1.9	2.2	1.9 (NIESR)		2.9
1985	3.5	2.8	1.5 (Cambridge Econom)		3.5 (S&C)
UK adult unemp. (millions)					
1984 Q4	3.1	3.08	3.0 (CBI)		3.14 (LBS)
1985 Q4	3.2	3.10	2.9 (CBI)		3.18 (S&C)

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Consensus is an average of available forecasts from
National Institute of Economic and Social Research - NIESR
London Business School - LBS
Phillips and Drew - P&D
Cambridge Econometrics
CBI
Simon and Coates - S&C
Henley Centre
Liverpool

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also journals - p 11*

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TREASURY ECONOMIC FORECAST, OCTOBER 1984: PUBLIC FINANCES

I attach a copy of the report on the outlook for **Public Sector Finances** in the Treasury Economic Forecast. This complements the main report on the forecast being circulated by Huw Evans.

MISS M E PEIRSON

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TREASURY ECONOMIC FORECAST

REPORT ON PUBLIC FINANCES

OCTOBER 1984

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SUMMARY

The main features of the forecast are:-

For 1984-85

- The PSBR is now put rather higher (possibly $\text{£}1\frac{1}{2}$ bn higher) than the Budget forecast of $\text{£}7\frac{1}{4}$ billion. Higher public expenditure is partly offset by higher North Sea taxes. However, the margin of error in forecasts made at this time of year is at least $\text{+ £}2$ billion.

*Say $\text{£}1\frac{1}{2}$ bn higher -
and one to
medium*

- The public expenditure planning total is expected to be some $\text{£}1\frac{1}{2}$ - 2 billion above the PEWP total of $\text{£}126\frac{1}{4}$ billion.

For 1985-86

- A positive fiscal adjustment (ie tax reductions) is still expected, possibly $\text{£}1-1\frac{1}{2}$ billion above the Budget forecast of $\text{£}2$ billion. The margin of error is however $\text{+ £}4-5$ billion. The increase in the fiscal adjustment results from higher North Sea and other taxes, which more than offset higher expenditure.

- The public expenditure planning total depends in part on the outcome of the survey, but without more cuts than in GEP's July assessment it seems likely to be above (perhaps $\text{£}1-1\frac{1}{2}$ billion above) the PEWP total of $\text{£}131\frac{3}{4}$ billion.

For 1986-87 and later

- Large fiscal adjustments are still foreseen. Despite continued forecast overspend on public expenditure plans, expenditure declines in real terms owing to the restraints imposed, whilst tax revenues continue to rise in real terms.

ASSUMPTIONS

1. The fiscal projections are crucially dependent on the assumptions employed, as follows:-

(i) The PSBR is constrained from 1985-86 onwards to the MTF5 projections, ie 2% of GDP in 1985-86 and 1986-87 and 1¾% in the next two years, by fiscal adjustments assumed to be taken on personal income tax. (On the revised forecast of GDP, this produces a PSBR of £7½ bn in 1986-87 rather than £7 bn as in the Budget forecast, which implicitly assumed 1.9%.) — 1.5% with 1.9%

NB. (ii) The miners' strike ends at the end of December, and coal restocking proceeds but not at an exceptionally rapid rate.

NB. (iii) The outcome of the public expenditure Survey for 1985-86 onwards is as in GEP's July assessment. For 1985-86 that means £3 billion of irresistible bids accepted and £1½ billion of cuts in programmes agreed, plus £1½ billion cut in the Reserve. Despite subsequent developments, GEP do not feel that this is too far away from the likely outcome. The extra £½ billion of asset sales in 1985-86 (see vii below) seem likely to be largely offset by the effect of revised economic assumptions (see paragraph 24 below). (The actual Survey decisions will be taken into account for the Autumn Statement.) Forecast outturn reflects not only these assumed increases and cuts in published programmes, but also likely longfalls and shortfalls.

(iv) Public service earnings rise at 6% pa (see main report), whilst nationalised industry earnings rise (with private sector earnings) rather faster.

(v) In 1985-86, adjustments to cash-limited plans are assumed to be limited to Survey bids and cuts and any subsequent "discretionary" allocations from the Reserve - see vi below. In the later years it is assumed that cash-limited plans are further adjusted for the effect of higher public service pay and prices (compared with PEWP assumptions), subject to a squeeze (maximum 2%) on the volume of cash-limited public expenditure. In all years demand-led items are unconstrained.

(vi) Net public expenditure increases are charged to the Reserve until that is exhausted, and then added to the planning total. Allowance is made for £1 billion a year of "discretionary" increases, as well as for overspends on local authority expenditure and nationalised industries' external finance, for demand-led increases, and for the effect of higher pay and prices on cash-limited programmes.

(vii) Asset sales are £2¼ billion in 1984-85 and £2½ billion in 1985-86, in line with PE's latest estimates, and £2 billion a year thereafter, by assumption.

(viii) Net payments to the EC in 1984-85 are based on recent decisions which suggest that the 1983 rebate will be received shortly and that there will be some supplementary financing. The 1984 rebate is assumed to be received in 1985-86, and later rebates received evenly throughout the year following that in which they arise: eg one-quarter of the 1985 rebate received in 1985-86, the rest in 1986-87. Further supplementary financing is assumed in 1985 and the VAT ceiling is raised in stages from 1% to 1.4% by 1 January 1986.

(ix) No new legislation on local authorities is assumed, but current legislation is carried through (eg abolition of GLC etc.). Measures to keep capital spending close to cash limits in 1985-86 onwards are introduced as necessary.

(x) There is full revalorisation each Budget of all income tax bands and allowances and specific taxes on expenditure.

(xi) National Insurance contribution rates are held constant for both employees and employers (rates for April 1985 must be decided this autumn). The Exchequer supplement to the Fund is held at 11%, despite the rapidly growing surplus on the Fund. The earnings threshold is uprated in line with prices, with the ceiling computed at 7.35 times the threshold (as in 1984-85) but rounded down to the nearest £5. Benefits are uprated each November in line with price increases to the previous May.

*8/2/85
J.R. 12/1/85*

PSBR

2. The fiscal prospects for 1984-85 are somewhat worse than in the Budget forecast. Our central projection for the PSBR is now £8¾ billion, ¹ £1½ billion higher. In 1985-86, however, the prospect is of a rather higher fiscal adjustment than in the MTFs projection.^x In later years the annual fiscal adjustment remains large.

Central projectionsFiscal Adjustment and the PSBR

	1983-84		1984-85		1985-86		1986-87		1987-88	
	Outturn	FSBR	October	FSBR	October	FSBR	October	FSBR	October	
PSBR (£bn)	9.7*	7.2	8.7	7.0	7.1	7.0	7.6	6.8	7.0	
PSBR (% of GDP)	3.2	2.2	2.7	2	2	2	2	1¾	1¾	
Fiscal adjustment from previous years (£bn)¢	-	-	-	-	-	1.9	3.2	6.6	7.7	
Annual fiscal adjustment (£bn)¢	-	-	-	1.9	3.2	4.7	4.4	3.4	2.9	

* New definition, excluding bank deposits; outturn on old definition was £10.0 bn.

¢ + means a reduction in taxes compared with current tax rates and indexed thresholds.

3. The contrast between a worsening in the fiscal prospect in 1984-85 and an improvement in 1985-86 compared with the Budget forecast can be explained largely by changes to the forecast of central government revenue. Expenditure is higher in both years by roughly the same amount. The upward revision since the Budget to North Sea taxes in 1985-86 (about £3 billion) is some £1¼ billion higher than that in 1984-85. And the revision to other receipts in 1985-86 is some £1¾ billion higher than that in 1984-85.

4. However, there are very large margins of error associated with these projections. Even for 1984-85, the margin of error is at least £2 billion in forecasts made at this time of year, and for later years it is considerably greater. Besides the inescapable errors involved in forecasting the difference between two large and partly unassociated quantities, additional uncertainties at present include:-

- the length of the **miners' strike** and the likely consequentials;
- the outcome of the public expenditure **Survey**;

x The improvement since the preliminary forecast in September stems largely from an increased forecast of non-North-Sea taxes.

¹ But see footnote page 11: the PSBR would then be £8½ bn.

- the effect of the privatisation of such a large industry as **British Telecom** on the PCBR, as it is taken out of the nationalised industry sector;
- the size of net **EC** contributions;
- the effect of **rate-capping** on local authority borrowing.

5. In judging the stance of fiscal policy, it is useful to look separately at the profile of North Sea taxes, the change in VAT on imports, and special asset sales. The first two items are essentially temporary influences and asset sales have much smaller economic effects than cuts in public expenditure.

Special factors affecting the PSBR

	1983-84	£bn							
		1984-85		1985-86		1986-87		1987-88	
		FSBR	October	FSBR	October	FSBR	October	FSBR	October
North Sea taxes	8.9	10.2	12.0	9.6	12.7	9.4	11.0	9.4	9.6
VAT on imports (change)	-	1.2	1.2	-	-	-	-	-	-
Special asset sales	1.0	1.9	2.3	2.0	2.5	2.0	2.0	2.0	2.0
PSBR	9.7	7.2	8.7	7.0	7.1	7.0	7.6	6.8	7.1

6. Since the Budget forecast the projections of North Sea taxes and asset sales have been revised upwards. This might imply an easier fiscal stance than earlier envisaged.

Sectoral split

7. The forecast worsening in the fiscal position in 1984-85 shows up in higher Central Government borrowing (higher expenditure, particularly grants to the Coal Board for the miners' strike, being only partly offset by higher North Sea taxes) and higher Local Authority borrowing (because of higher capital expenditure). In 1985-86 the improvement compared with the Budget is entirely in Central Government borrowing, the higher North Sea and other taxes more than offsetting higher expenditure. In later years the improvement in CG borrowing remains at about the same level, owing to growth in tax revenues generally (not just North Sea), but is offset to an increasing extent by forecast higher LA and PC borrowing.

Sectoral split of Borrowing

	£ billion									
	1983-84		1984-85		1985-86		1986-87		1987-88	
	Outturn	FSBR	October	FSBR	October	FSBR	October	FSBR	October	
CG own account (before fiscal adjustment)	8.2	5.3	6.5	3.8	1.9	-0.3	-2.4	-3.8	-5.9	
Local Authorities	1.2	1.3	2.0	0.9	1.4	1.0	1.7	1.1	1.8	
Public Corporations	0.3	0.6	0.2	0.5	0.6	-0.2	0.6	-0.5	0.6	
Fiscal adjustment (cumulative)	-	-	-	1.9	3.2	6.6	7.7	10.0	10.5	
PSBR	9.7	7.2	8.7	7.0	7.1	7.0	7.6	6.8	7.0	

Profile during 1984-85

8. A revised forecast of the profile of the PSBR during 1984-85, consistent with the forecast for the year as a whole, will be submitted separately.

Path of PSBR over forecast period

9. The table overleaf shows the principal influences on the PSBR in cash terms. There is a very sharp reduction forecast in the PSBR between 1984-85 and 1985-86, from £8½ billion to £4 billion (before fiscal adjustment). The miners' strike in 1984-85, which adds £1¼ - 1½ billion to the PSBR, is roughly offset by the once-for-all change in VAT on imports. The main reason for the forecast decline in the PSBR between the two years is that, whereas (ignoring the VAT change and the fiscal adjustment) total revenues are expected to rise by some £12 billion (8½%), much in line with the growth in nominal GDP, the public expenditure planning total is forecast to rise (ignoring the miners' strike) by only £6 billion (5%), even allowing for forecast overspend above plans.

10. Subsequently, there are further forecast sharp reductions in the PSBR (before fiscal adjustment), to roughly nil in 1986-87 and a negative borrowing requirement thereafter. These reductions too, and the corresponding large annual fiscal adjustments, stem from the growth of taxes broadly in line with the nominal growth in the economy, whilst expenditure is assumed to be held back.

SECRET & PERSONAL

INFLUENCES ON THE PSBR IN CASH TERMS

	1983-84	1984-85	1985-86	1986-87	1987-88
	estimated outturn		October forecast		
Central government taxes and contributions (before fiscal adjustment)					
: fbn	105.2	115.9	125.5	134.6	143.0
: % increase	6½	10	8	7½	6
: % increase (ignoring VAT change)	6½	9	9½	7½	6
o/w North Sea taxes:					
: fbn	8.9	12.0	12.7	11.0	9.6
: % increase	14	34½	6	-13	-13
Local authority rates					
: fbn	12.5	12.8	13.8	14.5	15.2
: % increase	1½	2½	8	5	5
Rent, dividends, interest and other receipts					
: fbn	11.4	10.7	11.0	11.4	12.0
: % increase	2	-6	2½	4	5
Central Government expenditure*					
: fbn	113.9	121.7	126.1	130.4	135.6
: % increase	9½	7	3½	3½	4
: % increase (ignoring miners' strike)	9½	6	4½	3½	4
Local Authority expenditure*					
: fbn	34.7	36.5	37.1	39.0	40.7
: % increase	15	5	1½	5	4½
o/w : relevant current					
: fbn	24.5	25.7	26.2	27.4	28.8
: % increase	7	7	2	4½	5
: capital					
: fbn	4.2	4.1	3.6	3.8	3.8
: % increase	22	-2	-13	5½	-
Public Corporations' borrowing					
: fbn	0.3	0.2	0.6	0.6	0.5
Special asset sales					
: fbn	-1.0	-2.3	-2.5	-2.0	-2.0
Public expenditure planning total ^x					
: fbn	120.5	128.0	133.0	139.0	144.9
: % increase	6	6¼	4	4½	4¼
: % increase (ignoring miners' strike)	6	5	5	4½	4½
General government debt interest					
: fbn	14.8	16.2	16.8	16.9	17.2
: % increase	2½	9½	3½	½	2

* Excluding special asset sales, lending to public corporations and debt interest. (Housing benefit is included under Local Authorities.)

^x Excluding national accounts adjustments made to other entries in table

CHANGES SINCE THE BUDGET

11. The table overleaf draws together the main changes since the FSBR in Central Government income and expenditure, and hence in the CGBR(0), and in the LABR and PCBR. In 1985-86 onwards, tax receipts and the CGBR(0) are shown before fiscal adjustment.

12. The main changes shown in the table are discussed briefly below. The increases in **expenditure** are then discussed more fully in the section on public expenditure.

1984-85

13. Higher **expenditure** accounts for the threatened overshoot on the PSBR in 1984-85 compared with the Budget forecast. The main changes are nearly £1¼ billion for the miners' strike (chiefly affecting CG grants to PCs and LAs in the table), £½ billion for the EC, £½ billion for debt interest (including interest support costs for ECGD) owing mainly to higher interest rates, and £½ billion of local authorities' capital overspend (affecting the LABR in the table), partly offset by nearly £½ billion of extra asset sales.

14. Higher **revenues** go only part way towards offsetting the expenditure increases. The main increase is £1¼ billion in **North Sea** taxes, reflecting both higher production and (mainly) higher sterling oil prices. The forecast also includes higher taxes on **expenditure** (nearly £¼ billion), reflecting slightly higher than expected VAT receipts so far this year. However, this is offset by lower **personal** taxes (-£½ bn), due partly to reduced earnings by miners, partly to higher mortgage tax relief (higher interest rates and greater volume of mortgages), and partly to a lower estimate of self-employment incomes in 1983. Forecast onshore **company** taxes are also slightly lower.

15. Because of some switches from loan to grant in respect of the Coal Board and Housing Corporation, the PCBR is now expected to be lower than in the Budget forecast. But the CGBR(0) is expected to be some £1 billion higher and the LABR £¾ billion higher (see also discussion of local authorities below).

CHANGES TO PSBR SINCE BUDGET

fbn

	1984-85	1985-86
<u>CG own account</u>		
<u>Income (incr +)</u>		
Personal taxes*	- 0.5	+ 0.5
Onshore company taxes	- 0.2	+ 0.3
North Sea taxes ^x	+ 1.5	+ 2.9
Expenditure taxes	+ 0.3	+ 0.5
National Insurance contributions	-	+ 0.3
Rent, dividends, interest	- 0.1	- 0.2
Trading surpluses etc	- 0.1	- 0.3
Other	+ 0.1	- 0.1
1. Total income	+ 1.1	+ 3.9
<u>Expenditure (incr +)</u>		
Supply (excl support for PCs and social security)	+ 0.4	+ 0.7
Social security (Voted, + nat ins)	-	+ 0.7
EC contributions	+ 0.4	+ 0.3
Special asset sales (affecting CGBR(0))	- 0.3	- 0.5
Debt interest (incl ECGD support)	+ 0.5	+ 0.8
Grants to PCs	+ 0.9	+ 0.1
o/w NCB	(+ 0.9)	(-)
Grants to LAs (incl housing ben)	+ 0.7	+ 0.2
o/w miners' strike policing	(+ 0.2)	(-)
Other	- 0.3	- 0.2
2. Total expenditure	+ 2.3	+ 2.1
<u>CGBR(0)* (row 2-row 1)</u>	+ 1.2	- 1.8
<u>LABR</u>	+ 0.8	+ 0.5
<u>PCBR</u>	- 0.4	+ 0.1
<u>Fiscal adjustment (cumul)</u>	-	+ 1.4
<u>PSBR</u>	+ 1.5	+ 0.1

^x Excluding ACT set off against MCT (this ACT is included in "onshore company taxes"). Table in paragraph 5 includes ACT. In 1984-85, such ACT is now estimated £0.3bn higher than in Budget.

* Before fiscal adjustment.

1985-86

16. As in 1984-85, expenditure and revenue are both expected to be higher in 1985-86 than in the Budget forecast. But by contrast with 1984-85, the forecast is that higher revenues in 1985-86 will more than offset higher expenditure, which is held back by cash limits etc. Clearly, however, the uncertainties surrounding the projections for 1985-86 are even greater than for 1984-85.

17. Higher expenditure in 1985-86 includes the following main changes since the Budget forecast: £1 billion for social security benefits, £½ bn because no net underspend on cash limits is now expected, £¼ billion for the EC, and £¾ billion for debt interest (reflecting in part higher borrowing in 1984-85 but mainly higher interest rates), partly offset by £½ billion of extra asset sales. (See below for further details.)

18. However, higher revenues much more than offset these expenditure increases. Again the main increase is £3 billion in **North Sea** taxes. In addition there is £½ billion on taxes on expenditure, reflecting higher growth in consumers' expenditure; £½ billion on **personal** taxes, reflecting the higher earnings in the main forecast; and £½ billion on onshore **company** taxes, reflecting the higher profits in the main forecast. **National insurance** contributions are slightly higher, reflecting higher earnings; but other CG receipts (of **interest** and **trading surpluses**) are lower, reflecting lower on-lending to LAs and PCs and increased claims on ECGD, respectively.

19. In consequence, the CGBR(0) is forecast almost £2 billion lower than in the Budget. Although the LABR is forecast nearly £½ billion higher (see discussion of local authorities below) this leaves the fiscal adjustment more than £1 billion higher.

Later years

20. The main message concerning the later years is that, so long as expenditure is controlled and revenue continues to grow in line with nominal GDP, the fiscal adjustment will grow sharply. This is so even though North Sea taxes are forecast to decline after 1985-86. Further details of the forecast for later years are available on request.

PUBLIC EXPENDITURE

21. The implications for the public expenditure planning totals are shown in the table overleaf.

22. The forecast of public expenditure for 1984-1985 is consistent with the position report to be circulated shortly by GEP;* the two reports make the same assumption about the end of the miners' strike.

23. For the **later years**, the likely outcome of the **Survey** is based on the July assessment (see Assumptions, page 2). On top of the assumed Survey decisions concerning the published plans for individual programmes, the forecast adds estimates of **longfall** (or shortfall), charging these to the Reserve until that is exhausted and thereafter assuming overspend over the published planning totals (see Assumptions, page 3).

Economic assumptions

24. These estimates of longfall take account of the changed economic circumstances since the **assumptions** circulated to Departments in July. A separate submission is coming forward on the assumptions concerning unemployment, interest rates and inflation which should now be put to Departments. These recommendations would cause Departments to put in further additional bids amounting to some £400 million in 1985-86/ ^{and £500 million in later years.} However, these prospective additions are already allowed for in the estimates of longfall in the present forecast.

Required Reserve in 1985-86

25. The table shows that the Reserve of £2¼ billion in 1984-85 is likely to be overspent by £1¼ billion, of which nearly £1¼ billion is accounted for by the miners' strike. In 1985-86, a Reserve of only £2¼ billion, resulting from the proposed Survey cuts, is forecast to be overspent by around £1¼ billion. That is, the **required** Reserve to avoid overspend is forecast to be at least £3½ billion in 1985-86, or over £1 billion higher than the actual Reserve in 1984-85. *of 72 3/4 bn.*

NB *Since the present forecast was finished, new information on housing subsidies suggests that the estimated planning total for 1984-85 to be reported by GEP may be somewhat lower; perhaps £127.8 bn.

SECRET & PERSONAL

PUBLIC EXPENDITURE PLANNING TOTALS

fbn

	1984-85		1985-86		1986-87		1987-88
	FSBR	October	FSBR	October	FSBR	October	October
1. PEWP less NIS <u>less Reserve</u>	126.3	126.3	131.7	131.7	136.3	136.3	139.1
	- 2.8	- 2.8	- 3.8	- 3.8	- 4.8	- 4.8	- 5.0
2. Baseline for forecast	123.5	123.5	127.9	127.9	131.5	131.5	134.1
<u>Forecast judgments</u>							
3. <u>CG</u> (excl support for PCs) and housing <u>ben</u>							
i) <u>Supply</u> (excl soc. security)							
Survey bids and cuts*	-	-	-	+ 0.1	-	- 0.1	- 0.3
Discretionary reserve	+ 0.6	+ 1.0	+ 1.0	+ 1.0	+ 1.0	+ 1.0	+ 1.0
Cash limits shortfall	- 0.4	- 0.4	- 0.5	-	- 0.5	-	-
Cash limits pay & prices	-	-	-	-	-	-	+ 0.8
Non-cash-lim (exc soc security)	+ 0.6	+ 0.6	+ 0.6	+ 0.7	+ 0.6	+ 1.1	+ 1.4
ii) <u>Soc security</u> (Voted, NIF, housing ben)							
Survey bids and cuts*	-	-	-	+ 0.5	-	+ 0.4	+ 1.6
Other	+ 0.4	+ 0.6	+ 0.4	+ 1.0	+ 0.5	+ 1.2	+ 1.3
iii) <u>EC Contributions</u>							
Survey bids & cuts*	-	-	-	+ 0.3	-	+ 0.1	+ 0.2
Other	-	+ 0.4	- 0.1	- 0.1	- 0.2	- 0.2	-
iv) <u>Other</u>	+ 0.2	- 0.1	-	-	+ 0.1	- 0.1	- 0.1
4. <u>Local authorities</u> (excl support for PCs & housing ben)							
i) <u>Relevant current</u>							
Survey bids & cuts*	-	-	-	+ 1.2	-	+ 1.2	+ 1.2
Other	+ 1.1	+ 1.3	+ 1.7	+ 0.3	+ 2.4	+ 1.1	+ 2.0
ii) <u>Other current</u> (excluding housing ben)	+ 0.2	+ 0.2	+ 0.2	+ 0.2	+ 0.2	+ 0.3	+ 0.4
iii) <u>Capital</u>							
Survey bids & cuts*	-	-	-	- 0.3	-	- 0.3	- 0.4
Other	-	+ 0.5	-	+ 0.1	-	+ 0.2	+ 0.1
5. <u>Nat. Inds. EFLs</u>							
Survey bids & cuts*	-	-	-	- 0.3	-	- 0.5	- 1.0
Other	-	+ 1.0	+ 0.5	+ 1.0	+ 0.6	+ 2.0	+ 2.4
6. <u>OPCs' cap. exp.</u>	-	- 0.3	-	-	-	-	-
7. <u>Special Asset Sales</u>	-	- 0.4	-	- 0.5	-	-	-
8. <u>Total</u>	126.3	128.0	131.6	133.0	136.2	139.0	144.9
9. <u>o/w Reserve</u> (after Survey cuts*)	2.8	2.8	3.8	2.3	4.8	4.0	5.0
10. <u>Overspend on reserve</u> (8 - 1)	-	1.7	-	+ 1.3	-	+ 2.6	+ 4.5*

Pub public vltm 4 3 4 5

* Survey bids and cuts in this table are those in GEP's July assessment.

x Excluding agreed increase in general uplift of programmes from 2½% to 3% (£1.3 bn).

26. The main reasons for this are that, in contrast to the expected outcome for 1984-85, no offset to expenditure increases is expected in 1985-86 from cash limits underspend (see under "Central Government" below) and that, even without much in the way of miners' strike effects, the nationalised industries' demands for external finance in 1985-86 are forecast to exceed published plans by a substantial amount (see under "Nationalised Industries" below).

CENTRAL GOVERNMENT EXPENDITURE

27. The main forecast changes in CG expenditure (excluding support for PCs but including housing benefit) compared with the PEWP plans are as follows, taking into account the Survey bids and cuts assumed as above:

- Following a £0.4 billion shortfall expected on CG cash limits in 1984-85, no net underspends in later years. This view on cash limits in 1985-86 and after diverges from earlier forecasts: for example, the Budget forecast assumed £½ billion pa underspend. It is assumed (see Assumptions, page 2) that the cash limit plans are adjusted for bids, cuts, any "discretionary" allocations from the Reserve, and - after 1985-86 - the effect of inflation subject to a volume squeeze (see below). This leaves them looking very tight, against the forecast of pay and prices: hence the forecast of nil net underspends.
- On Social Security (including housing benefit) overspend on the PEWP plans rises from £½ billion in 1984-85 to about £1¼ billion in 1987-88. Of this longfall, about £¼ billion pa reflects the effects of revised economic assumptions; the remainder reflects different estimates of the number of claimants. The social security forecast, and that for the National Insurance Fund, will be reported in more detail in a separate note by PSF division available on request.
- An allowance for overspend on other non-cash-limited items (eg IBAP, FPS) broadly in line with the forecast overspend in 1984-85.
- Higher net EC contributions up to 1985-86, reflecting the latest decisions and assumptions.
- Higher asset sales up to 1985-86.

SECRET & PERSONAL

28. The addition for higher inflation stems largely from the forecast that average public service wages will rise by 6% pa (see main report), considerably above that implicit in the 1984 PEWP plans. It is assumed that cash-limited plans in 1985-86 will not be adjusted for higher inflation; and that in subsequent years the addition necessary to compensate for the higher inflation will be offset in part by a squeeze on volumes up to a maximum of 2% on all cash-limited programmes. The latter includes defence, since the 3% NATO commitment will no longer apply, although it is likely that defence will have a share in the "discretionary" allocations from the reserve. As a result of the assumed squeeze, there is no net addition to plans before 1987-88, when the plans are increased by £¼ billion.

29. The net impact of these judgments and those for local authorities and public corporations (see below) implies considerable overspend on the Reserve, particularly in the later years. Despite this, the volume of central government expenditure is forecast to fall by over 2 per cent between 1984-85 and 1987-88 after rising in 1984-85. For example total CG employment is forecast to fall by over 100,000 between April 1984 and April 1988, compared with the planned reduction in Civil Service manpower of 30,000 over the same period.

LOCAL AUTHORITY EXPENDITURE AND BORROWING

30. Local authority relevant current expenditure is forecast very close to the Budget forecast in all years (adjusting the latter for the transfer of London Regional Transport (LRT) to the nationalised industry sector).

SECRET & PERSONAL

31. The settlement decided by Ministers for local authority targets in 1985-86 adds around £1 billion to the PEWP plans (£¼ billion below the bid assumed in July.) This is reduced by a further £¼ billion because of the transfer of LRT/ and other classification changes. The settlement is tough, and the various constraints on LA spending (such as rate-capping and grant hold-back) should moderate overspend.

32. However, LA manpower has not been falling recently (save in 1984 Q1) and it does not seem realistic to assume more than a 1-2% drop in manpower and around a 5% drop in the volume of procurement between 1984-85 and 1985-86. Given the forecast of public service wages and prices, this implies overspend on the settlement of around £¾ billion. The implied increase in rate income is nearly 8% in 1985-86.

33. LG division consider that this forecast of overspend in 1985-86 is towards the upper end of the range of likely outcomes.

34. In the later years, the forecast assumes little further drop in manpower or procurement volumes, and in 1986-87 some extra transitional costs are assumed for the abolition of the Metropolitan Authorities. The annual increase in rates is assumed to be 5%.

35. For LA capital, it is assumed that there are cuts in the published plans for 1985-86 onwards (including taking account of the overspend in 1983-84 and 1984-85) in line with the July assessment of the survey. It is also assumed that measures are adopted to keep LA capital close to the cash limits, and only a very modest amount of overspend is assumed. The resulting path of LA capital shows a £½ billion reduction between 1984-85 and 1985-86 and subsequently a little recovery.

36. LA borrowing is expected to be £¾ bn higher in 1984-85 than in the Budget forecast. The cause is the £½ bn capital overspend, plus the £¼ bn of expenditure on home improvement grants in late March 1984 which pushed up borrowing in April. However, in 1985-86 capital expenditure is expected to be £½ bn lower, and no special factor such as the home improvement grants is expected; consequently borrowing is forecast to revert to roughly the 1983-84 level and to rise only a little subsequently.

W/Cap. Det

NATIONALISED INDUSTRIES AND OTHER PUBLIC CORPORATIONS

37. The forecast for the NIs' external finance has been constructed afresh since the Budget. In particular, British Telecom and British Airways have been removed (and London Regional Transport added) from 1985-86 onwards. Despite this, the forecast for 1985-86 is very close to the Budget forecast.

38. In 1984-85, the miners' strike adds about £1 billion to expected external finance. Subsequently, some stock rebuilding is assumed but not at an exceptionally rapid rate.

39. The following table shows the build-up of the forecast of external finance and some of the factors contributing to the changes between the years:

Nationalised Industries' external finance: October forecast

	£bn			
	1984-85	1985-86	1986-87	1987-88
Capital requirements	6.3	5.7	5.3	5.5
o/w : fixed investment	(7.1)	(5.2)	(5.2)	(5.3)
: stock building	(- 0.7)	(0.4)	(0.1)	(0.1)
Internal resources	3.4	3.8	3.8	4.1
o/w : gross trading surplus	(4.4)	(5.0)	(5.2)	(6.0)
: interest & tax	(- 2.6)	(- 2.7)	(- 3.2)	(- 3.7)
External finance	2.9	1.8	1.5	1.4
Special factors:				
BT/BA (part year)	- 0.3	-	-	-
LRT	-	+ 0.3	+ 0.3	+ 0.3
miners' strike	+ 1.0	+ 0.1	-	-
corporation tax	+ 0.2	+ 0.3	+ 0.7	+ 1.2

40. The increase in forecast corporation tax payments shown above results in part from the 1984 Budget changes.

41. Allowing for the adjustment for LRT, the comparison with the Survey proposals and the Budget forecast is as follows:

External Finance: comparisons with Survey and Budget

	£ bn			
	1984-85	1985-86	1986-87	1987-88
IFR baseline	1.8	1.4	0.3	0.3
Survey cuts proposed	-	- 0.3	- 0.5	- 1.0
Resulting proposed published plans	1.8	1.1	- 0.2	- 0.7
U Forecast overshoot on proposed published plans	+ 1.1	+ 0.7	+ 1.7	+ 2.1
October forecast of total external finance	2.9	1.8	1.5	1.4
Budget forecast (adjusted for LRT after 1984-85)	1.8	2.0	1.1	..
Increase in forecast since Budget	+ 1.1	- 0.2	+ 0.4	..
o/w miners' strike	+ 1.0	+ 0.1	-	-

42. The present forecast assumes that the electricity industry raises its prices by 1% (real) in April 1985, and the gas industry by 3% (real), but that thereafter there are no real price increases/ These April 1985 increases are consistent with the "intermediate path" for prices proposed by the Treasury, but that path also assumed real price increases in later years.

43. Although the forecast external finance does not decline as steeply as in the Survey proposals, it still shows some decline, even after the drop in 1985-86 following the miners' strike. A major influence on internal resources is the growth in gross trading surpluses resulting from the price increases assumed, together with some gains in productivity and other cost savings. This offsets the effect of increasing corporation tax liabilities. Fixed investment is assumed to be roughly constant in cash terms, in line with PEWP plans, implying significant real reductions. Also, a slowdown in stockbuilding after the post-strike effects reduces capital requirements in the later years.

44. PE are in broad agreement with the assessment for 1985-86. For the later years, however, they consider that a more realistic assumption would be of

yes - and for
 some further real price increases. Every 1% price increase in the energy and water industries would reduce the forecast external finance requirements by £175 m a year.

45. The following table shows the forecast for total PCs' borrowing:

Public Corporations' borrowing					
	fbn				
	1983-84	1984-85	1985-86	1986-87	1987-88
NIs' external finance	2.3	2.9	1.8	1.5	1.4
o/w grant & subsidies	2.3	2.8*	1.8	1.4	1.3
leasing	0.1	0.1	0.1	0.1	0.1
CG on-lending	0.5	0.5	1.5	0.4	0.4
market & overseas borrowing	- 0.5	- 0.5	- 1.5	- 0.4	- 0.4
NIs' borrowing	-	-	-	-	+ 0.1
Other PCs' borrowing	0.3	0.2	0.6	0.6	0.6
PCBR - October forecast	0.3	0.2	0.6	0.6	0.5
- Budget	0.7	0.6	0.5	- 0.2	- 0.5
- change since Budget	- 0.4	- 0.4*	+ 0.1	+ 0.8	+ 1.0

* Affected by switches from loan to grant in respect of Coal Board and Housing Corporation.

COST TERMS

46. The table overleaf shows the main influences on the PSBR in "cost terms", ie deflated using the forecast GDP deflator.

47. In common with previous forecasts, the scope for fiscal adjustments from 1985-86 onwards is expected to stem from the buoyancy of **CG receipts**. Despite a sharp decline in North Sea taxes after 1985-86 (a year later than in the Budget forecast), **total CG taxes and contributions** (before fiscal adjustment and ignoring the VAT change in 1984-85) **are forecast to rise by 3-4% pa in cost terms from 1984-85 onwards.**

48. Part of this rise is due to the forecast growth in real earnings; part to growth of 1% pa or more in total employment; part to very strong forecast growth in real profits, particularly in 1984 and 1985 (more than 10% in each year), which affects corporation tax receipts in 1985-86 and 1986-87 respectively; and part to growth of 3-4% pa in real consumers' expenditure.

49. In contrast with the revenue side **public expenditure** shows a much **flatter path in cost terms** over the forecast period. The **planning total** rose by 1 $\frac{3}{4}$ % in 1983-84 and is expected to rise by a further 1% in 1984-85 and to remain roughly constant in 1986-87. **Ignoring the miners' strike, it would remain roughly constant over the whole period 1984-85 to 1986-87.**

50. In 1984-85 public sector prices seem to be rising a little more than prices in general, with some rise in volumes (particularly procurement and social security). In later years, volume and cost terms figures move roughly in line: although public sector earnings are expected to rise faster than prices in general, other important public sector prices are forecast to rise roughly in line with the general price level (eg the prices for social security and central government procurement) or below (eg local authority procurement).

SECRET & PERSONAL

INFLUENCES ON THE PSBR IN COST TERMS

	1982-83 prices			
	1983-84	1984-85	1985-86	1986-87
	estimated outturn	October forecast		
Central government taxes and contributions (before fiscal adjustment)				
: fbn	100.7	105.8	108.7	112.0
: % increase	2	5	3	3
: % increase (ignoring VAT change)	2	4	4	3
o/w North Sea taxes:				
: fbn	8.5	10.9	11.0	9.2
: % increase	9½	28	½	-16½
Local authority rates				
: fbn	12.0	11.7	12.0	12.1
: % increase	-3	-2	2	1
Rent, dividends, interest and other receipts				
: fbn	10.9	9.8	9.5	9.5
: % increase	-2	-10½	-2½	-½
Central Government expenditure*				
: fbn	109.1	111.1	109.2	108.6
: % increase	5	2	-1½	-½
: % increase (ignoring miners' strike)	5	1	-½	-½
Local Authority expenditure*				
: fbn	33.3	33.3	32.1	32.4
: % increase	10½	-	-3½	1
o/w : relevant current				
: fbn	23.5	23.4	22.7	22.8
: % increase	3	-	-3	½
: capital				
: fbn	4.1	3.8	3.1	3.2
: % increase	17	-7	-17½	1½
Public Corporations' borrowing				
: fbn	0.3	0.2	0.5	0.5
Special asset sales				
: fbn	-1.0	-2.1	-2.2	-1.7
Public expenditure planning total ^x				
: fbn	115.5	116.8	115.3	115.7
: % increase	1¼	1	-1¼	+¼
: % increase (ignoring miners' strike)	1¼	¼	-¼	+¼
General government debt interest				
: fbn	14.2	14.8	14.6	14.1
: % increase	-2	4	-1½	-3½

* Excluding special asset sales, lending to public corporations and debt interest.
(Housing benefit is included under Local Authorities.)

^x Excluding national accounts adjustments made to other entries in table.

15/10/84

SUPPLEMENT TO MINUTES OF PCC(84)33rd MEETING

II THE AUTUMN FORECAST AND WORLD ECONOMIC PROSPECTS (PCC(84)40 and (PCC(84)41))

1. Introducing the papers, Mr Evans said that there was general agreement amongst forecasters that there would be a slowdown in the US recovery and that, although elsewhere the recovery would continue, the net effect on world growth would be a decline. There were no signs of any significant inflationary pressures. The agreement on this contrasted sharply with the uncertainty about how long the US could continue with their present budget deficit. His own view was that the US could continue for some time to add to its internal and external debts and this view had been reflected in the forecast. While there might be a gradual reduction in the deficit and easing of US interest rates, he could not assume any sudden collapse. Moreover since growth in the United States had taken place without inflation, it was entirely possible that the slowdown might not reduce inflation or interest rates.

2. In the UK the prospects for output and inflation were broadly in line with the forecast at the time of the Budget. Taking output first, both exports and domestic demand were continuing to rise. With wages, employment, social security payments, dividends all rising in real terms, personal income and hence spending should show substantial rises. There was a strong investment boom and companies were in a good financial position (although interest rates were high, this was affecting stock levels more than investment). These factors suggested steady growth up to 1986. Given that stocks remained low (and the Budget changes and high interest rates were unlikely to encourage any major revival) there was less scope for a downturn in the cycle being triggered or exacerbated by destocking.

3. Inflation had remained broadly flat since early 1983 and this raised questions about whether the MTFs target of 3 per cent inflation by 1988 was still attainable. On the one hand, the slide in the exchange rate and the continuingly high inflationary expectations may have interrupted the underlying downward path of inflation over the past 18 months; it was possible therefore that the downward path could now continue. On the other hand, there was no obvious downward pressure on wages and there may not be much further adjustment on inflation to come given the steady growth that was now forecast.

4. There was little prospect of a decline in unemployment. Productivity was rising as was the size of the labour force. Many of the new jobs were being taken by women working part-time and this trend was not likely to change quickly.

PCC
SUPPLEMENT
ON THE
FORECAST
WORLD
ECONOMIC
PROSPECTS

5. Turning to public financing, Mr Evans pointed out that if Cabinet held to the planning totals, then 1985-86 would show an increase of only 3 per cent in cash terms over the current year. This was well below the prospective increase in revenues and it also amounted to a substantial cut (for the first time for many years) in real terms. On the face of it, this suggested scope for either higher expenditure or lower taxes. However, the forecasters expected there to be some over-spending on the planning total. Moreover, revenue buoyancy was very largely due to higher oil revenues and higher prices (and the level of public expenditure was reduced by higher asset sales) and these beneficial factors were not fully sustainable in the longer term. The fiscal position therefore looked easier than it really was and if expenditure were allowed to overrun, the UK would remain with a high tax, high expenditure economy which would not be compatible with lower interest rates.

6. The forecasters had, in any case, revised upwards their forecast for interest rates - but even so it was assumed that there would be continuing decoupling between the UK and US rates. Domestic monetary growth should remain within targets.

7. Concluding, Mr Evans pointed out that the Treasury forecast had given more weight to the performance of the UK economy since 1980 (when prices, unemployment and output were in line with the average in the other major economies) rather than the period before that where UK performance was noticeably worse. Perhaps as a result of this, the Treasury forecast was more optimistic than outside forecasts.

8. In discussion, the following points were made:

Public Expenditure

While the forecast had taken GEP's assessment of the likely outcome of the Survey, it was possible that in the event the outcome could be better than this. However, there was also a very considerable risk the other way - since to hold the targets would represent a very real rolling back of public expenditure and would require decisions cutting deep into departmental policy (this explained the difficulty with the current Survey). Moreover, the apparent size of the fiscal adjustment might weaken Ministers' resolve to hold public expenditure targets. There was a further danger that the outcome of the Survey might be to hold to existing plans, but in such a way (perhaps by reducing the Reserve) that made an

expenditure overrun extremely likely. To continue on this basis would undermine the whole process of public expenditure control through the planning total.

Pay and Earnings

The forecast increase of 7½ per cent pa in the current pay round and 6½ per cent in the next round although uncomfortably high, might nevertheless prove optimistic. With better company finance, and a growing sentiment that many employees were entitled to "catching-up" increases on top of a cost of living increase, there were likely to be upward pressures on earnings - and this could feed through to the public sector both as a result of any comparability and ordinary market pressures.

Interest Rates

So long as the US continued to be able to fund its budget deficit, there was little pressure on the United States to reduce it and therefore US interest rates could well remain high. However the optimism about the United States, which was leading to the strong dollar could fall away in an atmosphere of anti-climax after the election. In the UK, over the forecast period, there were bound to be some volatility in interest rates and this would lead to occasional difficulties with monetary aggregates.

Inflation

The prospects were not too bright, given that downward expectations were flattening out despite the fact that the UK was still a relatively poor performer compared with other major economies. There were [real] doubts about whether the 3 per cent target could be achieved on the basis on the present monetary targets.

Employment

Although the fall in manufacturing employment may have stopped and the rise in overall employment continue, it was clear that employment was still not responding adequately to the overall increase in output. The inadequacies of the labour market were a major influence on this, since there was no mechanism whereby the unemployed could influence the wage negotiation process. Moreover, with little further significant success on either growth or inflation to look forward to; and with high US interest rates offsetting the beneficial effect of the reining back of public expenditure, there was a real danger that pressures to increase public expenditure in order to affect employment directly would become irresistible. It was important that any such measures, if taken, should not be taken in a hurry. To ensure cost-effectiveness, options should be

considered well in advance. In particular, any initiatives should be concentrated on tackling the rigidities in the labour market.

9. Summing up the discussion, Sir Peter Middleton said that three main issues arose out of the discussion:

- (i) the substantial uncertainty about the prospects for world growth and interest rates;
- (ii) the impact of the labour market rigidities both on the forecast and on the policy stance;
- (iii) the pressure put by the high level of unemployment; the high world interest rates; and the apparent size of the fiscal adjustment available were all putting severe pressures on the present fiscal and monetary policy mix.

Sir Peter Middleton invited Sir Terence Burns to write a commentary on the forecast and to draw out the policy implications. He concluded by congratulating the forecasters on a substantial, and well written piece of work - produced to a very tight timetable.

Circulation of Supplement: those present

Sir P Middleton

Sir T Burns

Mr Bailey

Mr Littler

Mr Wilson

Mr Anson

Mr Byatt

Mr Cassell

Mr Kemp

Mr Monck

Mr Unwin

Mr Battishill

Mr Culpin

Mr Peretz

Mr Evans

Miss Peirson

Mr Watson

19 October 1984

CONFIDENTIAL

FROM: JON SHIELDS
DATE: 15 October 1984

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
Sir T Burns
Mr A Bailey
Mr Kemp
Mr Battishill
Mr Evans
Mr Scholar
Ms Seammen

ECONOMIC ASSUMPTIONS

I attach a draft letter for you to send to No 10 about the proposed economic assumptions for public expenditure. It reflects the outcome of the Chancellor's meeting this afternoon.

2. It is important that the assumptions listed here can be circulated to relevant Departments as soon as possible. However, there may be concern at the way the new assumptions on unemployment and prices are described.

J.S.

JON SHIELDS

CONFIDENTIAL

The Prime Minister will wish to be aware of the economic assumptions which the Chancellor is proposing

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DRAFT PRIVATE SECRETARY LETTER TO NO 10

~~I had told you I would be writing with to set out the~~
Updated economic assumptions are required for public expenditure in the years 1985-86 to 1987-88. [These will be worked into the figures currently being discussed in MISC 106.] Most will be published in the Autumn Statement, the Government Actuary's November Report or the Public Expenditure White Paper.

sketch
sketch

sketch
sketch

Most of the figures will be published in one or other of these documents and they will of course be consistent with figures that will appear in the Industry Act forecasts. Those most likely to attract public attention at the time of the Autumn Statement are:

For the Autumn Statement the main assumptions are:-

Main Economic Assumptions

	<u>Unemployment</u> (GB, narrow, millions)	<u>Inflation</u> (per cent rise in RPI, year to May)	<u>Average Earnings</u> (per cent rise, underlying year on year)
1984-85	3.0	-	7½*
1985-86	3.0	4¾	7*

3. The figure for unemployment in the current financial year 1984-85 should not in itself cause much surprise. As the total, on the definition used by the Government Actuary (GB, excluding school leavers and temporarily stopped), ~~had~~ ^{stood} already reached nearly 3 million on a seasonally-adjusted basis in September, ^{so} the ^{assumption} ~~proposed~~ figure implies, ^{broadly, little change} that the level will stay steady or rise slightly over the next few months. It has recently been rising at the rate of 10-15,000 per month. However, ^{but it is of course higher than the figure of 2.85 million} the last published assumption for the year 1984-85 ^{which was published} shown in the February 1984 PEWP and repeated in the July Report of the Government Actuary was 2.85 million.

4. For 1985-86, projections are inevitably more uncertain.

* These figures reflect "underlying" increases which take no account of the impact of the miners' dispute. The miners' dispute will probably reduce the 1984-85 figures to about 7 per cent and raise the 1985-86 figure to 7½ per cent.

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There has been considerable surprise at the failure of unemployment to turn down, or at least rise more slowly, over recent months in the face of the continued economic recovery and the strong growth in employment over the turn of the year. Most outside forecasters now expect unemployment to go on rising for some time. In such circumstances, ^{but} it would ^{seem} be unwise to base further expenditure projections on an assumption that unemployment will start falling soon. The proposed figure of 3.0 million for 1985-86 is consistent with little net movement through the year.

5. On inflation, the last published figure of $4\frac{1}{2}$ per cent for the RPI increase up to the end of 1984 ^{now} looks a little optimistic. It is however likely to be much nearer to the eventual outcome (probably about $4\frac{1}{4}$ per cent) than commentators thought at Budget time. The likely overshoot is more than ~~all~~ explained by the rise in mortgage interest rates. It is possible that the 12-month figure could rise again early next year to about 5 per cent, reflecting the path of the RPI through last year, but ~~this does not conflict with~~ the underlying path ^{should} still ^{be} being downward. The proposed assumption that the 12-month increase will be about $4\frac{1}{4}$ per cent next May would be consistent with these general trends, ~~although there is perhaps more a risk of it being exceeded than undershot in that particular month because of the path of the RPI last May.~~

6. There are some ^{complex} difficult presentational issues connected with the assumptions about increases in average earnings. These are not of great importance to the public expenditure projections, but are needed by the Government Actuary to forecast income from National Insurance Contributions.

7. The earnings figures for 1984-85 will be heavily influenced by the effects of the miners' dispute. Even on the assumption that the strike is settled by the end of the year the simple loss of miners' earnings during the dispute will reduce the average increases for the financial year by about $\frac{2}{3}$ per cent. Thus, an "underlying" increase of about $7\frac{1}{2}$ per cent will reduce to just under 7 per cent. In 1985-86, we would get the opposite

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effect: taking a reduced 1984-85 level as "base" the recorded increase between the years would be raised by about 2/3 per cent. Although some reduction in "underlying" increases is to be expected between the years, the relevant figures would than look like an increase from 7 per cent to 7½ per cent.

8. To ~~get around~~ ^{avoid this presentational difficulty} this problem without distorting the Government Actuary's calculations, ~~it is proposed~~ ^{the Chancellor proposes} to ask him to give greater prominence in his explanation about the figures to an "underlying" reduction from about 7½ per cent to about 7 per cent than to the actual figures. In smaller print, qualitative mention will be made of the impact of the miners' dispute and of the figures of 7 per cent and 7½ per cent respectively which have actually gone into his forecasts.

Later years of the Survey

9. Assumptions ~~are~~ ^{are} also needed for the later years in the Survey period. Those on unemployment and prices have in previous years not been published until the Public Expenditure White Paper. This year, they might be revealed earlier if total expenditure figures are to be provided. The proposed paths are as follows:

Economic Assumptions in Survey Period

	<u>Unemployment</u>		<u>Inflation</u>
	(GB, narrow, millions)		
		<u>RPI</u>	<u>GDP Deflator</u>
		(per cent rise in year to May)	(per cent rise)
1984-85	3.0	(5.1)	4¾
1985-86	3.0	4¾	4½
1986-87	3.0	4	4
1987-88	3.0	3½	3¾

10. The assumption of a flat path for unemployment after a recent rise is fairly conventional. The last set of published figures showed unemployment staying at 2.85 million for the years 1984-85 to 1986-87. Reflecting the increases that have actually taken place this year, the proposal is now to show

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a level of 3.0 million for all years. ~~This was the path agreed for Departments' internal projections in July.~~

and GDP deflators. The figures are likely to cause no surprises. RPI

11. On the RPI, no change is proposed for May 1986 from the figure of 4 per cent shown in the last PEWP. A further deceleration to 3½ per cent is assumed for the year to May 1987.

12. The GDP deflator is the main "price" assumption used in determining the cost-terms levels of particular programmes and the Planning Total itself. It therefore has important implications for any commitments made in real terms. It is also one of the main assumptions identified in the MTFS path for money GDP.

13. The path of the GDP deflator can deviate quite substantially from the RPI in the short term. [Differences can reflect coverage (particularly the inclusion of the mortgage rate in the RPI) and the impact of import prices.] Nevertheless, the paths shown above are fairly close to each other. Like the RPI, the assumptions for the GDP deflator are slightly above the last published figures for the earlier period (the MTFS showed a 4 per cent rise rather than 4½ per cent in 1985-86) but are similar thereafter. The figure for 1987-88 has been shaded down from 3½ per cent to 3¼ per cent.

McLoche

S E C R E T

FROM: A M W BATTISHILL
DATE: 15 October 1984

CHANCELLOR OF THE EXCHEQUER


cc Chief Secretary
Sir P Middleton
Mr Bailey
Sir T Burns
Mr Monck
Mr Burgner
Mr Scholar
Mr Wilson
Mr Pratt
Mr Ridley

TIMING OF AUTUMN STATEMENT

I attach a draft minute to the Prime Minister reporting on the timetable difficulties and the conclusions reached at your meeting this morning.

2. I have deliberately tried to cut through the detail in order to expose the options more clearly.

3. In the interests of speed I am asking others to let Mr Peretz have comments direct.



A M W BATTISHILL

S E C R E T

DRAFT MINUTE TO THE PRIME MINISTER

THE AUTUMN STATEMENT

I have been giving further thought to the timing of the Autumn Statement in the light of our conversation before the Party Conference and the latest information from Kleinworts about the progress of arrangements for launching the BT sale. This has thrown up important issues which I must report to you.

2. I now think it would be better if I could announce our public expenditure decisions in the House, and publish the Autumn Statement, on Monday 12 November, a day earlier than we had been planning. This would be the penultimate day of the Queen's Speech Debate. It would remove any cause for complaint the Opposition might have if we delayed the Autumn Statement until Tuesday 13 November, when they are likely to want to debate the economy. It would also clear the way for BT privatisation later in the month. At present, this is planned for the end of that week, with the price to be fixed on Thursday, 15th and announced on Friday 16th November ("Impact Day"). John Wakeham, with whom I discussed this briefly before the Party Conference, thought that a Statement on 12th November was far better than one on 13th November.

3. Publishing immediately after the weekend will halve the time normally taken to put the finishing touches and to print the Autumn Statement after Cabinet. The printers will have to be asked to work over the weekend, and through Sunday night. The Chief Secretary and I will be dependent on colleagues' co-operation in quickly agreeing the detailed programme figures^{after} Cabinet and the text to go into the printed Statement. But the operation looks feasible so long as public expenditure is firmly settled at Cabinet on Thursday 8th November.

4. This last requirement is a critical one. If, for any reason, we are unable to reach agreement on the spending figures (at least for 1985-86, if not for all three years) on the 8th, there is no way the Autumn Statement can be ready by

the 12th. The Economic Debate on the 13th would have to proceed without the public spending figures or the published Autumn economic forecast. And I would have to make a separate statement when we had settled the figures.

5. We could, however, be in real trouble over BT. We have all along known, this year, that more time might be needed to reach satisfactory decisions on public expenditure, given the extreme difficulty of some of the issues involved. That is why I asked you to bring forward discussion in Cabinet to 4th October, and why colleagues agreed to the setting up of MISC 106. So far as BT is concerned, we raised with Kleinworts some weeks ago the scope for setting back Impact Day by a week if slippage in the Autumn Statement made that necessary. Whilst not something we would wish, I had understood that this option remained available to us at least until we could see how far MISC 106 succeeded in closing the spending gap.

6. Unfortunately, in the last few days Kleinworts position has hardened. They are now firmly opposed (except for genuinely perceived market reasons) to any postponement; and say that a last-minute postponement could so imperil the sale that it might be necessary to pull back and defer the whole operation into 1985.

6a But nor could we simply let the public spending decisions, and the Autumn Statement, slip a week and still go ahead with BT on 16th November. This would put us in an impossible position. On the one hand, Kleinworts regard it as totally unrealistic to publish decisions of this importance between Impact Day on 16th November and the start of dealings in BT shares on 3rd December. On the other hand, if they (and the Autumn forecast) were not announced, we could be held to be in breach of the usual disclosure rules (including those of propriety as well as strict law) in such cases - bearing in mind particularly the size and uniqueness of the BT sale.

7. Against that background, I have had undertaken an urgent review of the courses open to us. I think there are three possible options:

- (a) to maintain the present timetable, accepting that public expenditure may not be finally settled by the 8th November Cabinet and that the Autumn Statement may then slip;
- (b) to leave BT Impact Day at 16th November but to decide now to postpone announcing our public expenditure decisions and publishing the Autumn Statement until the second week in December;
- (c) to decide now to put back the Autumn Statement and BT by one week to 20th and 23rd November respectively.

8. I cannot pretend that any of these courses are free from difficulty, or from risk. And for reasons I come to a choice between them needs to be made this week.

(a) Staying where we are

9. You will wish to make your own assessment of the likelihood of reaching a satisfactory outcome on public spending in just over three weeks from today. I understand the Lord President is planning to complete the work of MISC 106 and report to you by Friday 2nd November. His report could then be circulated after the weekend for Cabinet on the 8th. This allows precious little time for the task he has been set: little more than two weeks if there is to be some margin for you to bring your own influence to bear in trilateral discussions of the most sensitive issues. There may be some scope for rearrangement, but (my officials having consulted the Cabinet Secretariat) I can see no way of ensuring that the matter can go back to Cabinet on 8th November with the degree of assurance which you will want that the outcome will be a satisfactory one. But, for the reasons I have explained, we would then be in great difficulty over BT, with the risk of having no satisfactory fall-back position.

(b) Postponing the Autumn Statement to December

10. This is what Kleinworts want if there is risk of slippage at all. And they would want to do it soon. The Autumn

Statement would probably have to go back to Tuesday 11th December. Though not totally unprecedented (the public spending decisions were announced on 2nd December in 1981) it would be later than before.

11. I am not at all attracted by this course. It is already known that MISC 106 has been set up, and it would be bound to slow the momentum in reaching decisions and reduce rather than increase the prospect of a satisfactory outcome.

12. Equally important is the risk to markets. To go into the BT sale before public spending has been settled and announced, and with a risk of damaging speculation about the difficulty of reaching decisions, would be most unwise. Kleinworts are inclined to play this down, but I think they are wrong.

(c) Postponing the Autumn Statement and BT by one week

13. As I have said, Kleinworts opposed to this. Although they are not legally committed to Impact Day on 16th November, they have raised a number of objections. These are partly matters of confidence and partly of logistics.

(a) Apparently, 16th November is already widely perceived as the chosen date - in the City, among regional brokers and the press. And Kleinworts fear that any postponement would be interpreted as implying that the sale had run into problems.

(b) There would, they say, be severe planning and logistical problems: advertising space has been booked (and might be difficult and costly to replace); the BT roadshow has been arranged and invitations issued to key people; and the key pathfinder period (between the announcement of a price on 16th November and the start of dealings on 3rd December) carefully judged at three weeks.

14. Even allowing for some overstatement in Kleinworts presentation, I accept that these are real difficulties. New advertising space could cost £8-10 million. Financial institutions will have arranged for funds to mature on a certain date. A decision to postpone by a week would undoubtedly involve disruption; and in addition to the measurable costs, there could be some risk to the price.

15. Nevertheless, if there is to be a postponement, Kleinworts would like the decision to be taken as quickly as possible. That must be right.

What to do ?

16. I am afraid there is no easy solution. If we could be sure of settling public expenditure by 8th November, and on satisfactory terms, the programme we have is the best possible. But it also carries the highest risk - that, in the event of slippage, we may not be able to go ahead with BT this year.

17. I feel that this risk is too great for us to take. With the best will in the world, there must be a distinct chance that we shall not be in a position to secure satisfactory decisions by 8th November.

18. I would propose, therefore, that we take a decision now to set back the Autumn Statement and the BT programme by one week, to give a few more precious days to decide our spending plans. I do so with reluctance, but in the belief that this would be the safest course to take. There will be costs, but less than running risks of getting the wrong public spending decisions because we run out of time.

19. If we do decide to postpone I see no need to alter the MISC 106 timetable or at this stage to abandon the hope of getting public spending settled on 8th November. If we were to succeed, the Autumn Statement could still go ahead on Monday 12 November in time for the Economic Debate the following day. But by taking a decision now, we would have created a week's cushion in case more time proves necessary.

20. I regret having to trouble you with this issue at such short notice. I have not, of course, been able to discuss it yet with Norman Tebbit. But in view of the urgency I thought you should know of the problem at once.

21. The Chief Secretary and I are at your disposal if you would like a discussion.

[22. I am copying this to Norman Tebbit.]

[N.L.]



Handwritten red notes: "As to the 24th" with an arrow pointing to the right.

Handwritten blue notes: "I fear I haven't ~~proof~~ read this. 15/10/84 but it's overdue, anyway. Original draft before, also" with initials "mp" at the top right and bottom right.

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

PRIME MINISTER

THE AUTUMN STATEMENT

I have been giving further thought to the timing of the Autumn Statement in the light of our conversation before the Party Conference and the latest information from Kleinworts about arrangements for launching the BT sale. This has thrown up important issues which I must report to you.

2. I now think it would be better if I could announce our public expenditure decisions in the House, and publish the Autumn Statement, on Monday 12 November, a day earlier than we had been planning. This would be the penultimate day of the Queen's Speech debate. It would remove any cause for complaint the Opposition might have if we delayed the Autumn Statement until Tuesday 13 November, when they are likely to want to debate the economy. It would also clear the way for BT privatisation. At present, the BT price is to be fixed on Thursday, 15th and announced on Friday 16 November ("Impact Day"). John Wakeham, with whom I discussed this briefly before the Party Conference, thought that a Statement on 12 November was far better than one on 13 November.

3. Publishing immediately after the weekend will allow ^{US} ~~as~~ little time ~~normally taken~~ to produce the Autumn Statement after Cabinet. The printers will have to work over the weekend, and through Sunday night. Peter Rees and I will be dependent on colleagues' quick agreement after Cabinet to the detailed programme figures and to the text for the printed Statement.

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But the operation looks feasible so long as public expenditure is firmly settled at Cabinet on Thursday 8 November.

4. This last requirement is a critical one. If, for any reason, we are unable to reach agreement on the spending figures (at least for 1985-86, if not for all three years) on the 8th, there is no way the Autumn Statement can be ready by the 12th.

The Economic Debate on the 13th would have to proceed without the public spending figures or the published Autumn economic forecast. And I would have to make a separate statement when we had settled the figures.

5. But in that case we could be in real trouble over BT. We have always recognised that more time might be needed to reach satisfactory decisions on public expenditure this year, given the extreme difficulty of some of the issues involved. That is why we agreed to bring forward discussion in Cabinet to 4 October, so that colleagues could agree quickly to the setting up of MISC 106. So far as BT is concerned, we raised with Kleinworts some weeks ago the scope for setting back Impact Day by a week if slippage in the Autumn Statement made that necessary. Whilst not something we would wish, I had understood that this option would remain available to us at least until we could see how far MISC 106 succeeded in closing the spending gap.

6. But in the last few days Kleinworts have let us know that they are opposed to any delay and that they believe that a postponement left until the last minute could so imperil the sale that it might be necessary to pull back and defer the whole operation into 1985.

6a. We could not, however, let the public spending decisions, and the Autumn Statement, slip a week and still go ahead with BT on 16 November. On the one hand it is accepted on all sides that the Autumn Statement cannot be published in the interval between Impact Day on 16 November and the start of dealings



in BT shares on 3 December. On the other hand, if they (and the Autumn forecast) were not announced, we could be held to be in breach of the usual disclosure rules (including those of propriety as well as strict law) in such cases - bearing in mind particularly the size and unique nature of the BT sale.

7. Against that background, I have reviewed the courses open to us. There are only three feasible options:

(a) to maintain the present timetable, accepting all the risk that implies;

(b) to leave BT Impact Day on 16 November but to decide now to postpone announcing our public expenditure decisions and publishing the Autumn Statement until the second week in December;

(c) to decide now to put back BT by one week to 23 November, leaving open the possibility of deciding later to postpone the Autumn Statement to 20 November.

8. I cannot pretend that any of these courses is free from difficulty, or from risk.

(a) Staying where we are

9. First there is the question of the risk that we might not be able to reach a satisfactory outcome on public spending in just over three weeks from today. I understand the Lord President is planning to complete the work of MISC 106 and report to you by Friday 2 November. His report could then be circulated after the weekend for Cabinet on the 8th. This allows precious little time for the task he has been set. MISC 106 would have little more than two weeks if you are to



have time to bring your own influence to bear in trilateral discussions of the most sensitive issues. There may be some scope for rearrangement, and my officials have consulted the Cabinet Secretariat about this. But I can see no way of being sufficiently sure that on this timetable we would get a satisfactory outcome. But if at that late stage we found we needed a second Cabinet to resolve outstanding issues, we would then be in great difficulty over BT, with no satisfactory fall-back position.

(b) Deciding now to postpone the Autumn Statement to December

10. Although I understand this is Kleinwort's preferred option, if we see any risk of slippage on the date of the Autumn Statement, I am not attracted by it at all. Though not totally unprecedented it would be later than before. But more importantly, it would be bound to slow the momentum in reaching public expenditure decisions and reduce rather than increase the prospect of a satisfactory outcome. And it is already known that MISC 106 has been set up to go into the BT sale before public spending has been settled and announced, and with a risk of damaging speculation about the difficulty of reaching decisions would, in my view, be most unwise. Kleinworts are inclined to play this down, but I think they are wrong.

(c) Postponing BT by one week

11. As I have said, Kleinworts are opposed to this. Although they are not legally committed to Impact Day on 16 November, they have raised a number of objections. These are partly matters of confidence and partly of logistics:

(a) apparently, 16 November is already widely perceived as the chosen date - in the City, among regional brokers and the press. And Kleinworts fear that any postponement would be interpreted as implying that the sale had run into problems;



(b) there would, they say, be severe planning and logistical problems.

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12. Even allowing for some overstatement in Kleinworts presentation, I accept that there are real difficulties. [New advertising space could cost £8-10 million.] Financial institutions will have arranged for funds to mature on a certain date. A decision to postpone by a week would undoubtedly involve disruption; and in addition to the measurable costs, there could be some risk to the price.

13. Nevertheless, if there is to be a postponement, Kleinworts would like the decision to be taken as quickly as possible. That must be right.

Conclusion

14. I am afraid there is no easy solution. If we could be sure of settling public expenditure by 8 November, and on satisfactory terms, the programme we have is the best possible. But it also carries the highest risk - that, in the event of slippage, we may not be able to go ahead with BT this year.

15. I feel that this risk is now too great for us to take. With the best will in the world, there must be a distinct chance that we shall not be in a position to secure satisfactory decisions by 8 November.

16. I would propose, therefore, that we take a decision now to set back the BT programme by one week. I do so with reluctance, but in the belief that this would be the safest course. There would be costs, but less than those of getting the wrong public spending decisions because we ran out of time.



17. If we do decide to postpone, I see no need to alter the MISC 106 timetable or at this stage to abandon the hope of getting public spending settled on 8 November. And I think we should, for the time being, keep the possibility of taking a further week to a very close circle indeed. If we could keep to the 8 November timetable, the Autumn Statement could still go ahead on Monday 12 November in time for the Economic Debate the following day. But by taking a decision on BT now, we would have created a week's cushion in case more time proves necessary.

18. I am sorry to trouble you with this issue at such short notice. The difficulties over the BT timetable have only just become apparent. I have not, of course, been able to discuss it yet with Norman Tebbit. But in view of the urgency I thought you should know of the problem at once.

19. Peter Rees and I are at your disposal if you would like to discuss this.

[N.L.]