PO-CH/NL/0731 PART A

FOR DISPOSAL ADVICE SEE INSIDE COVER

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FILE TITLE

TRADE

FILE BEGINS 18/12/1986

ENDS 15/12/1987

RM2.25 CONFIDENTIAL

FROM: MOIRA WALLACE
DATE: 15 December 1987

MR P DAVIS

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Peretz
Mr Sedgwick
Mr R I G Allen
Mr Pickford
Mr Bottrill
Mr Young
Mr McLaren
Mr Owen
Mr Segal
Mr Cresswell - CSO
Mr Norgrove - No.10

BALANCE OF PAYMENTS FIGURES: THIRD QUARTER 1987

The Chancellor has seen your minute of 14 December, and is content with the draft press briefing. He has asked how the non-oil visible deficit for the first three quarters of 1987 compares with the first three quarters of 1986.

MPW.

MOIRA WALLACE

Ch/ The answer on this was:

1st 3 quarters 1986: -9010
1st 3 quarters 1987: -9709

Thanks

MPW
21/12

CONFIDENTIAL

FROM: PAUL DAVIS

DATE: 14 December 1987

1. MR BOTTRILL
2. CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Minister of State
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Peretz
Mr Sedgwick
Mr R I G Allen
Mr Pickford
Mr Young
Mr McLaren
Mr Owen
Mr Segal

Mr Cresswell CSO
Mr Norgrove No 10

Cx/ content with press briefing?

OK -

PS. How does the visible for the 1st 3 qtrs of 1987 compare with the 1st 3 qtrs of 1986?

BALANCE OF PAYMENTS FIGURES: THIRD QUARTER 1987

1. The invisibles and capital account figures for the third quarter will be published at 11.30 am on 15 December, together with revisions to the previous quarters.

2. The invisibles surplus is now estimated to have been £1.9 billion in the third quarter - slightly higher than the £1.8 billion projected by the CSO. The third quarter current deficit is now put at £1.1 billion compared to the £1.2 billion published in the trade figures press notice on 24 November. The invisibles surplus for the first half of 1987, however, has been revised down by £0.6 billion so that the current deficit for the first ten months of the year is now estimated at £1.5 billion. This compares to the Autumn Statement forecast of a £2½ billion deficit for 1987 as a whole.

3. The third quarter invisibles surplus is rather higher than the revised figures for the early part of the year with improved net earnings on services and interest, profits and dividends more than offsetting a recovery in net transfers to the EC. On present trends, however, the surplus for the year as a whole might be slightly lower than in 1986.

CONFIDENTIAL

Summary Table £ million

-6565

	1985	1986	1986 Q3	1986 Q4	1987 Q1	1987 Q2	1987 Q3
Visible balance	-2178	-8463	-2891	-2725	-1135	-2382	-3048
Invisibles	5066	7519	2035	1736	1707	1723	1902
- Services	5388	5081	1247	1321	1256	1245	1572
- IPD†	2954	4611	1488	1248	1304	1192	1339
- Transfers	-3276	-2173	-700	-833	-853	-714	-1009
Current Account	2888	-944	-856	-989	572	-659	-1146
Net transactions in external assets and liabilities*	-7775	-10965	1	-5346	2767	424	-2340
Balancing item*	4887	11909	974	5174	-2922	633	3570

† Interest, profit and dividends
* Not seasonally adjusted

Services (Table C)

4. The improvement in the services surplus in the third quarter included in particular higher net insurance earnings, although these reflected at least partly an unusually low level of claims which may not continue. Travel credits maintained their recovery from last year's low level but fuller information on the second quarter of 1987 has led to a higher estimate of UK tourists' spending abroad. This continued at a high level in the third quarter and the travel deficit for 1987 as a whole is likely to exceed last year's record. The deficits on civil aviation and sea transport have also continued to run ahead of last year's rate.

Interest profits and dividends (IPD) (Table D)

5. The IPD surplus is estimated to have risen by £0.1 billion to £1.3 billion in the third quarter. Earnings on direct investment overseas rose by about £0.2 billion reflecting an increase in oil companies' direct investment income partly as a result of BP's takeover of Standard Oil. On the debit side, however, profits due abroad on inward investment in non-oil companies also rose by £0.2 billion due to the strong rise in UK profits. Portfolio earnings fell further in the third quarter, partly because of the appreciation of sterling earlier this year. Payments on portfolio investment in

the UK continued to rise, so that net portfolio earnings fell. The net deficit on interest payments by UK banks on borrowing and lending, however, fell a little from the high second quarter figure.

Transfers

6. The transfers deficit rose by £0.3 billion to £1.0 billion in the third quarter. Receipts from the EC fell by £0.2 billion returning to about their level at the end of last year (the second quarter included a social fund receipt and the first quarter a large agricultural guarantee receipt). Payments to the EC changed little in the third quarter.

Transactions in external assets and liabilities (Tables G and H)

7. Net capital outflows of £2.3 billion were recorded in the third quarter, compared with inflows of £0.4 billion in the second quarter. With the recorded capital outflows and the current deficit in the third quarter, there was a positive balancing item (reflecting unrecorded inflows) of £3.6 billion, compared with unrecorded inflows of £0.6 billion in the previous quarter. A continued net outflow of direct investment abroad and a reversal of the second quarter's net foreign currency inflow to banks were only partly offset by net portfolio inflows to the UK.

Net Transactions

£ million

	1985	1986	1986 Q2	Q3	Q4	1987 Q1	Q2	Q3
Direct Investment	-4391	-5937	-678	-1716	-4007	-564	-4666	-3081
Portfolio Investment	-10999	-14644	-5043	-3305	-1840	+1141	+2574	+4217
Banks' net foreign currency lending abroad	+4900	+10459	+2880	+5830	+958	+3194	+4157	-3935
Banks' net sterling lending abroad	+2520	-350	-1392	-795	+11	+1198	+1357	+221
Other	+1953	+2397	+1455	+2308	-774	-679	+1471	+507
Official reserves	-1758	-2891	-296	-2321	+306	-1523	-4469	-269
Total	-7775	-10965	-3073	+1	-5346	+2767	+424	-2340

8. Direct investment outflows rose to £5.5 billion in the third quarter which included ICI's acquisition of Stauffer Chemicals (£0.7 billion), Thorn EMI's acquisition of Rentacenter USA (£0.4 billion), and WPP's purchase of JWT USA (£0.4 billion). There was a sharp rise to £2.4 billion in inward direct investment, with a number of new purchases including Centibel Holdings (£0.4 billion) and the Quicksave group (£0.1 billion). Portfolio inflows were a modest £0.1 billion in the third quarter as banks and security dealers divested themselves of overseas assets which almost offset other UK institutions' purchases. Portfolio outflows rose by £1.8 billion to £4.3 billion as foreigners bought UK gilts and company securities. Banks' borrowing in foreign currencies was £8.6 billion lower in the third quarter returning to a little above the first quarter level while lending was little changed, implying a large net foreign currency outflow. Sterling lending increased faster than sterling borrowing so the net inflow in the third quarter was £1.1 billion smaller than in the previous quarter. There was a modest increase in the reserves in the third quarter.

Assessment

9. The invisibles surplus of £1.9 billion in the third quarter together with revisions to the first two quarters brings the surplus in the year so far to £5½ billion compared with the Autumn Statement forecast of £7½ billion for the year as a whole. The figures, of course remain subject to further revisions but in general the invisibles surplus is not turning out as buoyant as hoped at the time of the Budget with net IPD earnings lower than expected - partly as a result of higher payments abroad by North Sea oil companies and partly probably reflecting the pound's strength which has reduced the sterling value of receipts.

10. I would appreciate clearance for the attached press briefing.

PAUL DAVIS
EA2

Draft Press Briefing for IDT

1. Invisibles surplus for 1987Q3 estimated at £1902 million, a little above CSO projection of £1800 million.

2. Why such large downward revisions to invisibles surplus in first half of 1987? Revisions to first two quarters' estimate reflects new information on services, especially on travel. Second quarter revisions close to original projection of £1.8 billion.

3. Further revisions to recent quarters' estimates possible as new information becomes available.

4. CSO estimates of invisibles unreliable. Estimates based on latest information available, new information coming in all the time. Always state that most recent quarter provisional.

5. Projection of invisibles balance in fourth quarter will be published in current account press notice for November on 23 December.

6. Autumn Statement forecast of invisibles too optimistic. Surplus of £5.3 billion in first three quarters compared with forecast of £7½ billion for 1987 as a whole. First estimate of 1987 surplus not available until March.

7. Large positive balancing item implies unrecorded inflows. May imply unrecorded current account credits or unrecorded capital inflows. Would not be surprising if some of errors occurred in current account.

SECRET AND PERSONAL until release of press notice on 23 December 1987 at 11.30 am and thereafter unclassified

pmp

So far so good!

To Minister for Trade

Copy No. 3. (27)

From Peter Stibbard
US/S2
V/260 Ext. 4872

15 December 1987

OVERSEAS TRADE FIGURES FOR NOVEMBER: EXPORTS

1 The **value of exports** in November, seasonally adjusted on a balance of payments basis, is estimated at £7.0 billion, £0.1 billion (1 per cent) higher than in October. Exports of oil were unchanged but exports of the erratic items fell by £0.1 billion. Excluding oil and the erratic items exports rose by 2½ per cent between October and November.

2 In the three months ended November the total value of exports increased by 5½ per cent compared with the previous 3 months; excluding oil and the erratic items the increase was 5 per cent.

3 In the three months ended November, total **export volume** was 6 per cent higher than in the previous three months and 4½ per cent higher than in the same three months a year ago. Excluding oil and the erratic items export volume rose by 5 per cent, to be 6½ per cent up on a year earlier. The underlying level of non-oil export volume has been rising steadily since April.

4 The export figures are shown in the attached table; charts plotting the main aggregates are also attached. The monthly press notice on November overseas trade is scheduled for release on Wednesday 23 December. A note describing November **imports** and the current account will be circulated on Friday 18 December. It will incorporate revised figures for **invisible trade** up to the end of September which were published today by the Central Statistical Office. These revisions increase the current account deficit in the first three quarters of 1987 by £0.5 billion.

P J STIBBARD

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on 23 DEC 87 at 11.30am and thereafter unclassified   Copy No...(   )

EXPORTS
(Balance of payments basis: seasonally adjusted)

		TOTAL TRADE			EXCLUDING OIL & ERRATICS		
		VALUE £m	VOLUME (1980=100)		VALUE £m	VOLUME (1980=100)	
1986	Q3	17553	122.6		14839	118.5	
	Q4	19340	130.5		15873	125.3	
1987	Q1	19637	130.0		15899	124.4	
	Q2	19388	126.3		15892	122.5	
	Q3	20362	130.7		16808	129.3	
1987	JUN	6394	123.4		5298	122.0	
	JUL	6762	130.9		5527	128.4	
	AUG	6566	126.6	AV	5424	124.9	AV
	SEP	7034	134.6	52.3	5858	134.6	43.5
	OCT	6867	132.4	51.9	5546	127.8	43.4
	NOV	6951	136.1	51.1	5696	131.7	43.2

Average values
(ie value/volume)
steeper fall in total trade
figure presumably because
£ oil price dropping. ✓

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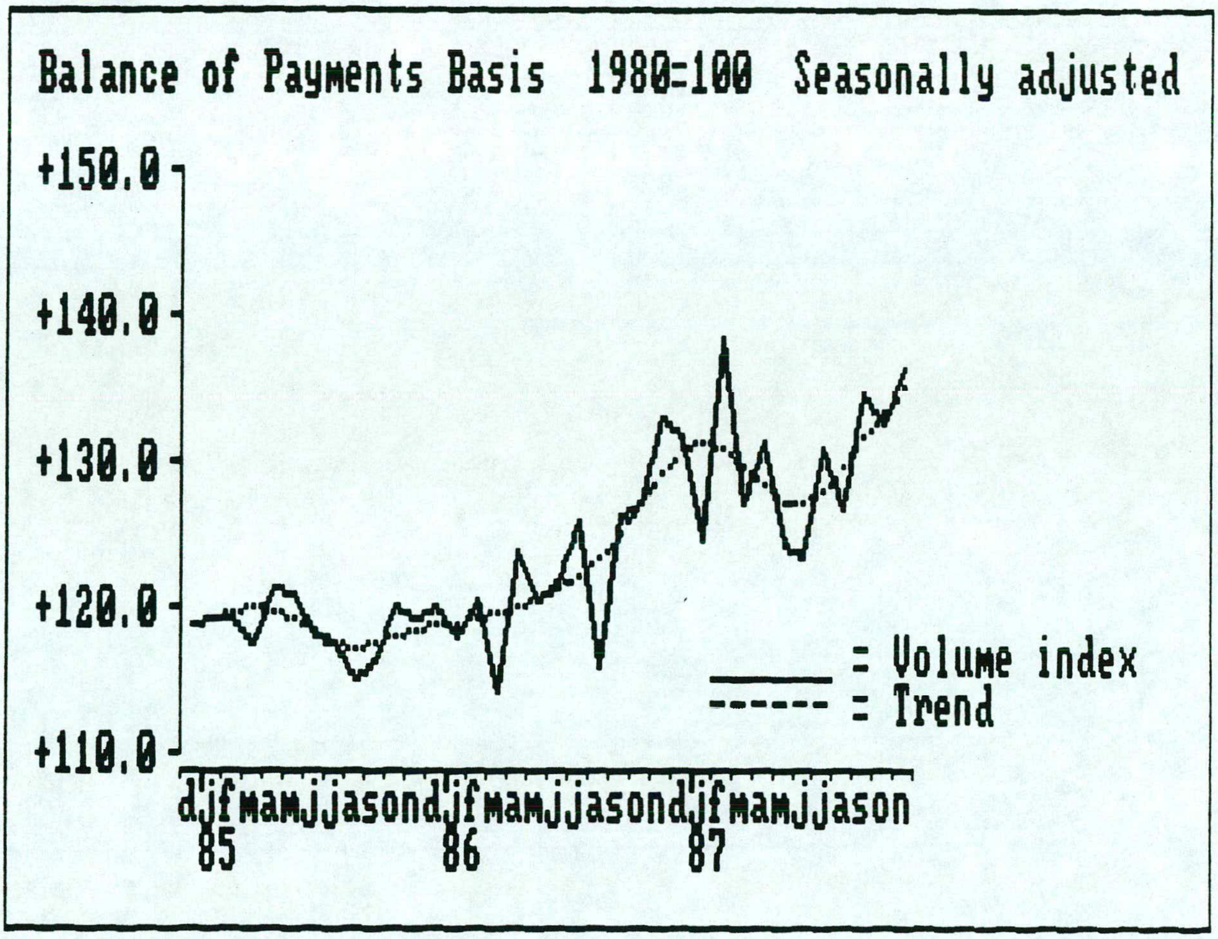
TOTAL EXPORTS



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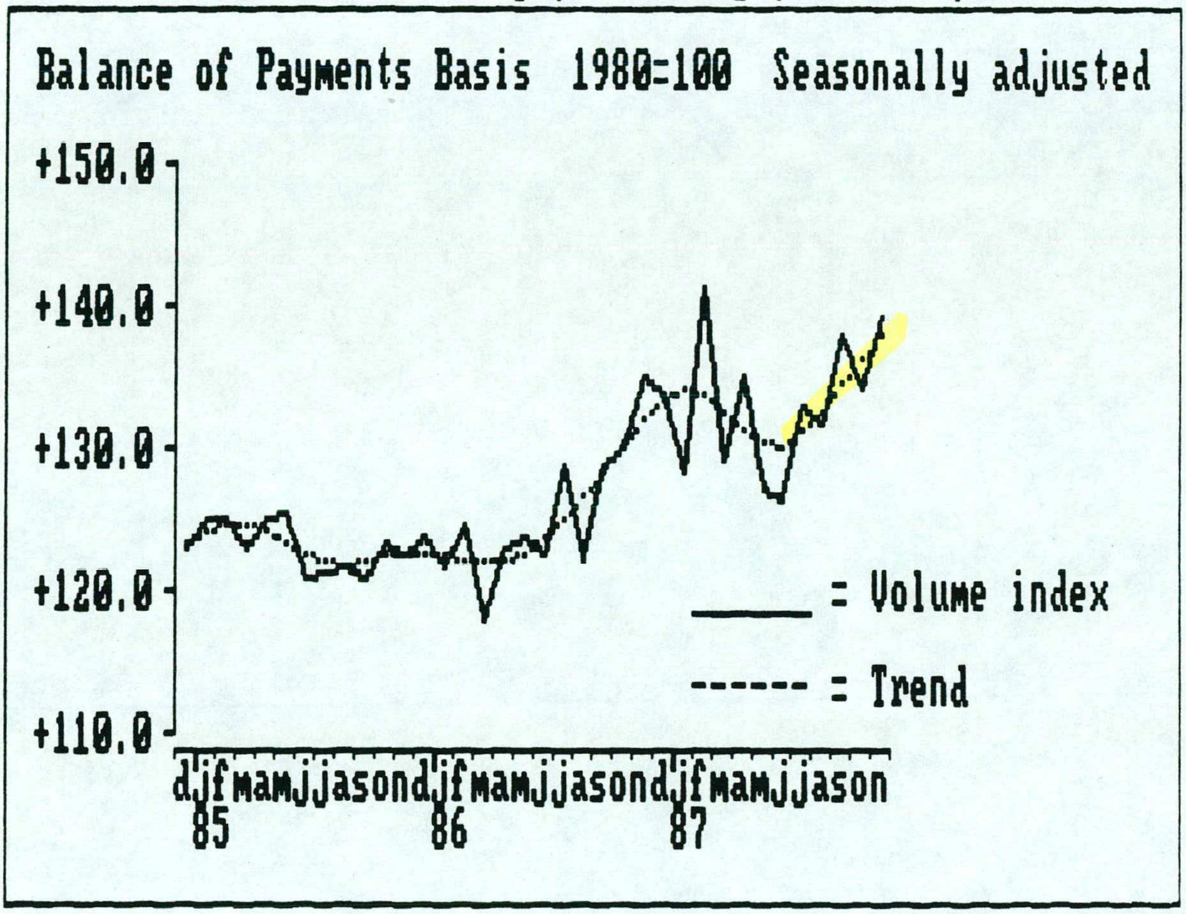
EXPORTS LESS ERRATICS (Ships,N Sea Rigs,Aircraft,Precious Stones & Silver)



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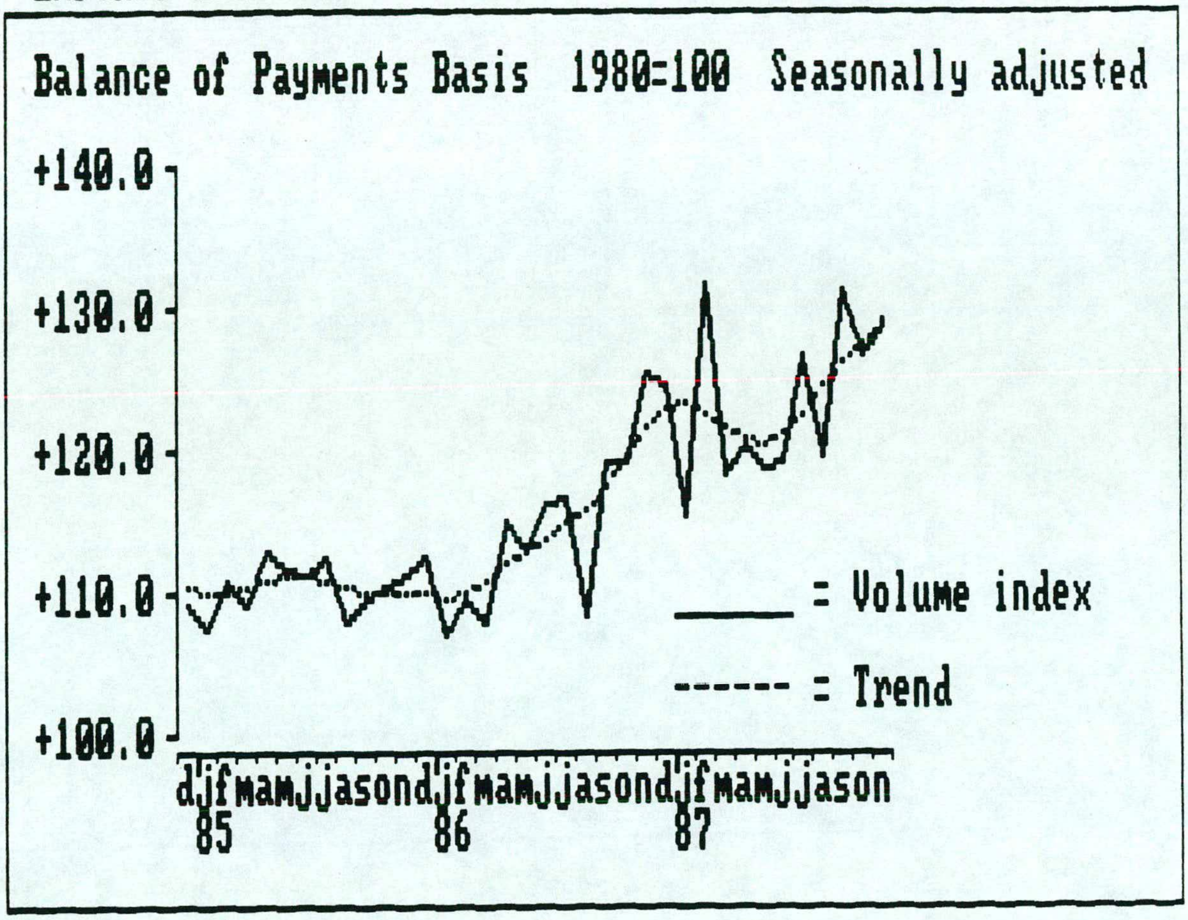
EXPORTS LESS OIL



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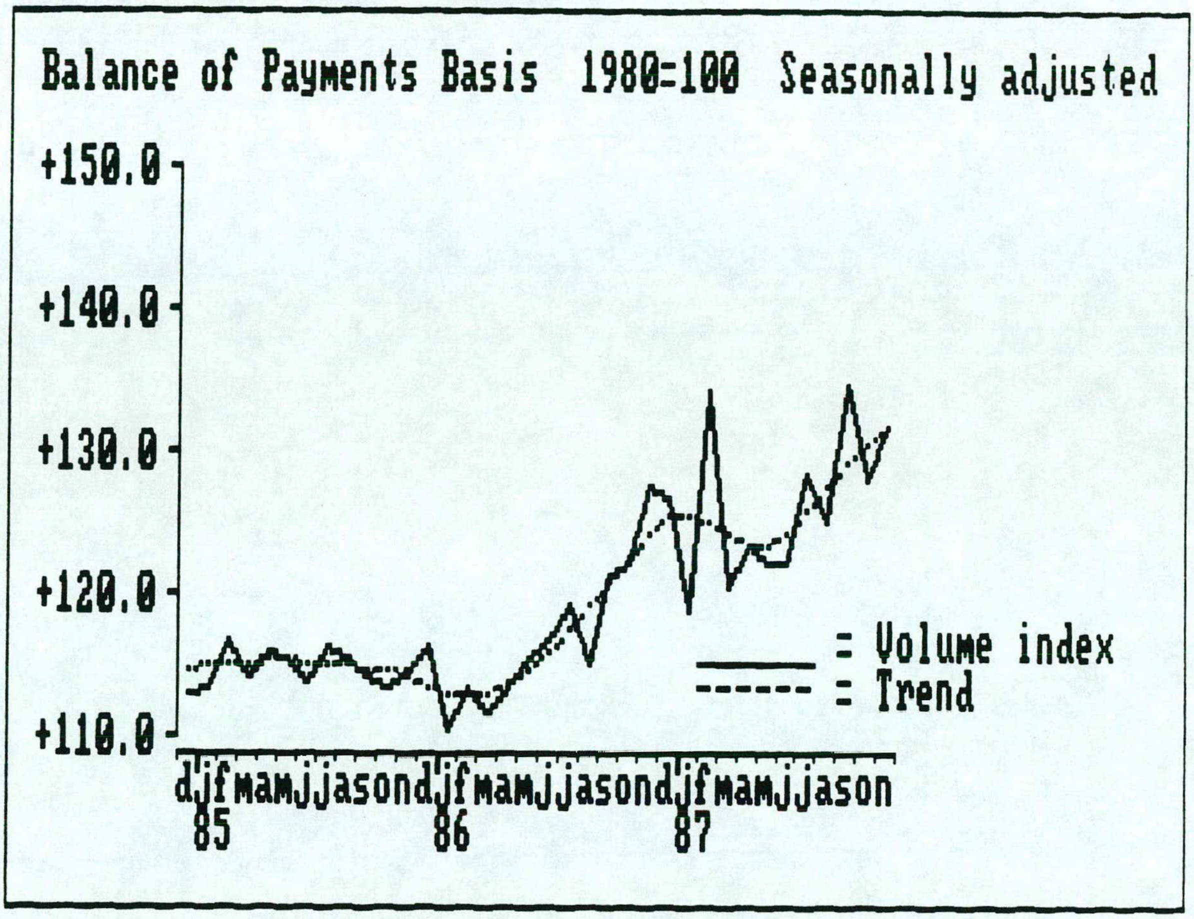
EXPORTS LESS OIL & ERRATICS



CIRCULATION LIST

Copy No 1	Minister for Trade	
2	Prime Minister	
3	Chancellor of the Exchequer	
4	Secretary of State for Trade and Industry	
5	PUSS for Trade and Industry	
6	Sir Robert Armstrong (Cabinet Office)	
7	Sir Brian Hayes (Dept. of Trade and Industry)	
8	Sir Peter Middleton (HM Treasury)	
9	Governor of the Bank of England	
10	Chairman of the Board of HM Customs & Excise	
11	Mr J Hibbert (CSO)	
12	Mr Pratt (HM Customs & Excise)	
13	Mr B Buckingham (CSO)	
14	Mr Davies (HM Treasury)	
15	Mr P Sedgwick (HM Treasury)	
16	Mr D Owen (HM Treasury)	
17	Mr A McIntyre (CSO)	
18	Mr D J Wilson (Dept. of Energy)	
19	Mr Bottrill (HM Treasury)	
20	Mr H H Liesner)	
21	Mr P J Stibbard)	
22	Mr W E Boyd)	
23	Mr E J Wright)	Dept of Trade and
24	Mrs A Brueton)	Industry
25	Miss C Siddell)	
26	Miss H Chapman)	
27	Mr D Packer)	

Ch
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so you can photo
wants [illegible]

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PUP

Sir T. Burns

Mr Pratt

cc: Mr Lankester
Mr Harris
Mr Heim
Mr Plumbly
Mr Ricketts
Mr Matthews (HMT)

Chancellor.
The figures are for October so there is very little J-curve, if any. There may be more to come later.
TB

We spoke.
SJ
10/12.

OCTOBER US TRADE DEFICIT

1. The merchandise trade deficit was a record $17.63 billion in October, well above market expectations. Imports were $39.38 billion, up 12% on September's level, and exports were $21.75 billion, up 4%. The monthly figures are not seasonally adjusted and are only available in value terms. The deficit for the first ten months of the year is $145.8 billion, up 5% on the same period in 1986.

2. The bilateral deficits increased with Japan, Canada, Mexico, Western Europe and OPEC. The deficit with Japan was $5.86 billion, up from $4.6 billion in September.

3. The rise in imports was broadly spread with cars and manufactured goods showing large increases. Oil imports rose 10.4% ($0.4 billion) in value terms and 9.9% in volume.

4. The foreign exchange markets reacted as expected by selling dollars. The rate changes are shown below:

	9.30am Dec 10	Close Dec 9	% Change in $
DM	1.6405	1.6605	-1.2
Yen	130.25	132.15	-1.4
£	1.8258	1.8052	-1.1

Gus O'Donnell

10 December 1987 A T O'DONNELL

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pmp

Sir T. Burns

Mr Pratt

cc: Mr Lankester
Mr Harris
Mr Heim
Mr Plumbly
Mr Ricketts
Mr Matthews (HMT)

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Gus O'Donnell

10 December 1987

A T O'DONNELL

FROM BRITEMB WTON 12/10/87 11:15 P. 1

Covering SECRET AND PERSONAL

PMP

FROM: PAUL DAVIS

DATE: 23 November 1987

MS WALLACE

cc: Chief Secretary
Economic Secretary
Financial Secretary
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Cassell
Mr Sedgwick
Mr Peretz
Mr Bottrill
Miss O'Mara
Mr R I G Allen
Mr Barrell
Mr Owen
Mr Patterson/Mr Pickford
Mr Norgrove - No 10

OCTOBER TRADE FIGURES

I attach a revised version of the press briefing for IDT incorporating the Chancellor's suggestions.

PAUL DAVIS
EA2

SECRET AND PERSONAL
UNTIL 11.30 am THURSDAY 24 NOVEMBER
THEN UNCLASSIFIED

DRAFT BRIEFING FOR IDT

Positive

1. Export volumes (excluding oil and erratics) in three months to October 8 per cent higher than a year earlier and on firm upward trend. Forecast to rise further in 1988.

2. Manufacturing industry performing well. Volume of manufacturing exports (excluding erratics) 11 per cent higher in three months to October than a year ago. Output up 6 per cent comparing third quarter with a year earlier.

3. CBI Survey for November shows export order books above normal by biggest margin ever.

Defensive

1. Large current account deficit in latest three months. Recent figures volatile - latest three months includes erratically high August deficit. Deficit in first ten months of 1987 only £1.1 billion - very small as share of GDP (¼ per cent), much smaller than imbalances in other major countries, and well within Budget/ Autumn Statement forecast of £2½ billion deficit for 1987 as a whole.

2. Current account deficit forecast to rise further in 1988. Projected deficit of £3½ billion only ¾ per cent of GDP - much smaller than imabalances in US, Germany and Japan (currently 3-4 per cent of GDP/GNP) and UK deficit in mid 1970s (also 3-4 per cent of GDP).

3. Autumn Statement forecast of £2½ billion current account deficit in 1987 too pessimistic: Forecasts for 1987 still subject to substantial margin of error. Data revisions quite likely before first complete estimate of 1987 current account published next March.

4. Current account deficit no longer "temporary" as Chancellor earlier claimed. Deficit reflects fast growth of UK economy relative to all other major economies. No reason to suppose that deficit will not decline as growth rates converge.

5. Rise in current account deficit confirms economy overheating? No. Current account deficit on its own does not imply overheating. Rather reflects underperformance of rest of world economy.

6. Trend in imports strongly upwards. Recent figures very erratic, but inevitable that there should be some rise in imports as the economy expands. Imports of semi manufactures, capital and intermediate goods reflect rising output and investment, as expected.

7. Imports rising faster than exports [In three months to October on a year earlier, import volumes (excluding oil and erratics) up 12 per cent, compared with 8 per cent rise for exports. On previous three months import volumes up 5½ per cent while exports up 4 per cent.] Not surprising given that UK economy is growing faster than all other major economies. As growth overseas picks up, UK exports should benefit. Import growth should slow in 1988 as UK growth moderates.

8. Fall in exchange rate needed - sterling's recent strength threatens competitiveness: Not at all. Competitiveness remains 10 per cent better than in 1984 and 1985. Period of stability in exchange rate now desirable - sentiment endorsed by CBI.

9. Export growth projected to slow in 1988: UK projected broadly to maintain volume share of total world trade in manufactures, continuing improved performance which has been evident since 1981, following decades of decline.

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

11. Government relying too much on invisibles [Morgan Grenfell economists suggest Autumn Statement forecast too optimistic in light of stock market crash.] Autumn Statement took account of recent movements in financial markets. Falls in securities markets have increased the uncertainties in forecasting, but invisibles to remain in substantial surplus.

12. Effect of stock market fall on investment income. Position has been affected on both sides of account by movements in financial markets and by exchange rate changes but too soon to be precise about effect on net overseas asset position or income from these assets. Note that share prices generally back only to end-1986 levels, which is date to which latest published net overseas assets figures relate.

13. Official statistics understate strength of UK current account performance. [Phillips & Drew article 'Lies, Damn Lies and Invisible Statistics' published 8 October 1987, alleged current account may actually be in surplus in 1987 so far and in previous years due to underrecording of invisible exports following ending of exchange controls.] True that growth in securitised market makes apportioning of portfolio earnings more difficult. Balance of payments balancing item rose to £11.7 billion in 1986 reflecting either unrecorded net current account credits or net capital inflows. Would not be surprising if some errors in current account.

PS to look into the alternatives of X, & let me have a note after the ~~CS~~ CS.

FROM: H J BUSH
DATE: 20 May 1987

CHIEF SECRETARY

Ch

Pretty odd - why do we need to provide this facility to BAe, who are surely capable of covering their own risk in the markets (options etc)

cc Chancellor
Sir G Littler
Mr Mountfield
Mrs Case
Mr Gieve
Mr Kelly
Mrs Dunn
Mr R Smith

ECGD : BAe APPLICATION FOR TTC COVER

Under the TTC scheme ECGD covers UK exporters against the risk of exchange rate fluctuations between tender and contract. The general size of contract covered is of the order of £30-40 million. BAe who are bidding for a US Defence Department rapier missile order, have applied for cover on a contract of £550 million. Since this case passes the basic test (that a foreign currency bid is required) cover will be given next Tuesday on payment of an upfront premium.

2. The scale of this contract could expose what is a small £2 million demand-led programme to considerable loss (or, indeed, gain). ECGD's maximum liability would amount to 24 per cent of contract value, around £110 million net of premium receipts. This would require an appreciation of the £ to \$2.10. However, even smaller appreciation would lead to substantial loss - around £50 million at \$1.90. An appreciation up to 5% above current levels would be covered by premium receipts from BAe.

3. Given the large scale of this contract ECGD have considered whether they might hedge their own exchange risk under this deal. However, to put ECGD in a no loss position would cost over £10 million - a certain cost which would prove fruitless if either the contract was not won or exchange rate appreciation did not materialise. ECGD are considering the question but are unlikely to recommend hedging. We would be inclined to support this view on three grounds:-

(i) the large size of the hedging premium in relation to the risk of loss and the size of the TTC programme (though this might be taken as indicating that the market perceives the risk of appreciation as a real one).

(ii) the Government's policy of holding the sterling exchange rate at around current levels;

(iii) the oddity of the Government appearing to insure itself against the risk of its exchange rate policy failing (the size of the transaction means it is likely to be noticed).

Are you content with this line?

4. ECGD will need to take account of the public expenditure implications of this case in estimating requirements in the Survey. We do not see the case itself as providing a Treasury argument for further restricting the scheme which was only recently reviewed. Indeed, the expense and difficulties of covering forward in the market for this size of risk is the main argument for the ECGD scheme. Without it, it is questionable whether UK firms would be in a position to bid for orders of this size.

X

Harry Bush

H J BUSH

5/141

Papers Pre

This note surprisingly makes a strong case - exceptionally - for keeping the scheme rather than closure. N.

FROM: H J BUSH
DATE: 19 June 1987

CHANCELLOR

cc PS/Chief Secretary
Sir G Littler
Mr Mountfield
Mrs Case
Mr Gieve
Mr Kelly
Mrs Dunn
Mr R Smith

ECGD : TTC COVER

You asked before the Election (Mrs Ryding's minute of 21 May) for an assessment of the argument that without ECGD's TTC scheme it was questionable whether UK firms would be able to compete for large foreign currency denominated export orders.

The Scheme

2. The Tender to Contract (TTC) scheme, first introduced in 1977, offers UK exporters some protection against adverse exchange rate movements when tendering for major capital projects (£10 million+) in certain foreign currencies. Subject to a maximum liability and a first loss provision, the exporter is guaranteed the current spot sterling rate (ie the rate at which he priced his bid) until the time (at contract signature) when he can with certainty enter the forward market. This cover costs firms an initial non-refundable premium of 0.05% of the contract value and additional amounts up to 4.5% of contract value, graduated according to the period between tender and contract. The scheme was for a long time accounted for as an ECGD trading facility. However, it was agreed in the last PES round that from 1 April 1987 it should be borne on demand-led public expenditure programme estimated at £2 million per annum.

Alternatives to TTC

3. We have pressed on a number of occasions for the scheme's closure (because of consistent losses) but DTI Ministers have been keen to maintain it with the strong support of the exporting lobby. There are no adequate commercial alternatives. Schemes

run by the banks have been slow to develop (even at the £10 million end of the market not covered by TTC) and involve very much higher up front charges. This is true a fortiori of the currency options market which is the only real alternative for larger projects: a 9 months "at the money" option might cost 4% or more depending on contract size. The exporter would be liable for that regardless of whether the contract was won or not (though he might gain if sterling had in the meantime depreciated). In the case of the BAe bid for a £550 million contract an option would cost perhaps £20 million. Aside from the size of this charge in relation to the pricing of an individual bid, there is a more general sensitivity to upfront premium because the low chance of success (estimated now at 1 in 20) in an extremely competitive project market loads these costs onto the successful bids. Indeed, there was an outcry when TTC up-front premium was increased in 1984 and, following a review last year, the premium structure has been revised in a financially self-balancing way to meet this concern.

Overseas schemes

4. The UK is not alone in running an exchange risk scheme: most major European overseas export credit agencies have responded to similar pressures. (These are not so important for the Americans because of the predominance of dollar denominated contracts.) Indeed, in some currencies the lack of effective forward markets means that their agencies' schemes are sometimes more wide ranging than ECGD's TTC, guaranteeing the exporter the spot exchange rate prevailing at tender throughout the life of the contract. The French scheme, though, is similar to ours, but with a flat rate of 0.2% to 0.4% it is relatively much cheaper for a successful contract and more expensive for the unsuccessful.

Conclusion

5. The nature of the risk covered by TTC (and the likelihood of cover being sought more when the £ is appreciating than when it is depreciating) implies a considerable risk of subsidy. However, ECGD's remit to break even on the scheme taking one year with another provides us with an entrée to keep the costs

within bounds by tightening terms. In view of this, DTI Ministers would, as in the past, oppose closure because commercial alternatives provide neither the coverage (being geared to smaller export contracts) nor the favourable up-front pricing of the ECGD scheme. In their absence firms bidding for large foreign currency project business would either have to absorb the risk themselves or go to the options market and pay up to 4% upfront. Given the limited likelihood of success in today's competitive market this would be a significant deterrent to UK firms entering the market.

Harry Bush

H J BUSH

CONFIDENTIAL

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

FROM: PHILIP NASH

DATE: 13 JULY 1987

Nigel

Thanks

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Paymaster General
Mr Scholar

IMPORTATION OF PETER WRIGHT'S BOOK "SPYCATCHER"

1. You asked for our advice on customs powers in relation to the importation of Peter Wright's book "Spycatcher".

2. There are no provisions under existing legislation which would empower us to prevent the book from being imported.

3. It is possible that Department of Trade and Industry, using powers under the Import, Export and Customs Powers (Defence) Act 1939, could prohibit the book or make importations of it subject to licensing requirements. Our view is that the scope of Section 1(1) of the Act is sufficiently wide to allow this to be done, but essentially this is a matter for DTI and their legal advisers. Certainly it would be, as far as we are aware, an unprecedented use of the Act to ban a single, specified item as distinct from all goods from a particular source eg Argentina. Moreover, DTI are known to be extremely anxious to use the powers given them under the Act highly selectively, because these powers are so extensive. They fear that if the powers came under Parliamentary scrutiny - especially over their use in a controversial case - their continuing existence would come under threat. It is also possible that import control could be regarded as a restriction on trade between EC Member States and contrary to the Treaty of Rome. If the control did not extend to other Member States, the loophole would be obvious and would be seen as rendering the control pointless.

4. Assuming DTI did impose an import ban (which could be done by Order signed by an Assistant Secretary or above), we could not guarantee to prevent copies of the book from entering the country. Although we might have some

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Internal distribution: CPS
Mr Knox
Solicitor
Mr Weston
Mr Allen
Mr Ball

CONFIDENTIAL

chance of detecting commercial importations in freight or copies sent by post - at the considerable opportunity cost of diverting resources from drugs work or collecting revenue - we could not hope to prevent importations by individual passengers. Resources would not allow us to carry out the checking that would be required. Inevitably our staff would look askance at any priority given to this activity over drugs work.

5. In the event of a ban being imposed, there could be difficulties over copies that slipped through. We could, of course, seize copies of the book when they were detected in the country having escaped our controls at ports and airports. Such action would be controversial especially if it led to our seizing copies from MPs or journalists who might well be disposed to brandish the book in order to court publicity. On the other hand to do nothing would be to invite justified criticism of the Government's decision to impose a ban in the first place.

6. I regret that I cannot provide a more positive response, but it would be foolish to promise more than we can deliver.

PHILIP NASH

SECRET AND PERSONAL
UNTIL 11.30 am FRIDAY 23 OCTOBER
THEN CONFIDENTIAL

FROM: PAUL DAVIS
DATE: OCTOBER 1987

1. MR BOTTRILL
2. CHANCELLOR OF THE EXCHEQUER

cc: See attached list

C/content with press briefing? CR

OK

SEPTEMBER TRADE FIGURES

The September trade figures will be published at 11.30 am on Friday 23 October. They will show a deficit on visible trade of £655 million. Combined with an unchanged CSO projection of the monthly invisibles surplus of £600 million, they give a projected current account deficit of £55 million in September compared to a deficit of £929 million in August. In the third quarter the current account was in deficit by £1293 million, the largest recorded quarterly deficit in nominal terms (though it was exceeded as a proportion of GDP in the first quarter of 1979). In the first nine months of the year, the current account deficit was £796 million.

Main points

2. **Current account** £ million

	1986 Year	Q3	Q4	1987 Q1	Q2	Q3	July	Aug	Sept
Manufactures	-5491	-1741	-1826	-736	-1860	-2235	-625	-1284	-327
Oil	4056	621	785	1164	1033	942	284	374	284
Other goods	-7028	-1771	-1684	-1563	-1534	-1800	-569	-619	-612
Total visibles	-8463	-2891	-2725	-1135	-2361	-3093	-910	-1529	-655
Invisibles	7483	1981	1765	1807	2187	1800*	600*	600*	600*
Current balance	-980	-910	-960	672	-174	-1293	-310*	-929	-55

* projection

3. The value of exports rose by £0.4 billion between August and September and imports fell by a similar amount; hence the visible deficit in September was £0.9 billion smaller than in August. In the third quarter as a whole the visible deficit rose by £0.7 billion to £3.1 billion, reflecting a £0.6 billion rise in the non-oil deficit and a £0.1 billion fall in the oil surplus. Over the same period the manufacturing trade deficit widened by around £0.4 billion to £2.2 billion.

4. **Exports**

	percentage change		
	Sept on Aug	Third quarter on previous quarter	Third quarter on same period year earlier
Total value	6½	4½	16
Total value excl. oil and erratics	7½	6	13
Total volume	6	3½	6½
Total volume excl. oil and erratics	7½	6	9½
Manufactures volume (excl.erratics, OTS basis)	9	7½	11
Fuels volume (OTS)	-8	-4	-6
Basic materials volume (OTS)	-9	3½	-1½
Food, drink and tobacco volume (OTS)	6	7	-½

5. Export volumes, excluding oil and erratics, rose by 7½ per cent in September reflecting increases in exports of manufactures and food, drink and tobacco. In the third quarter export volumes of manufactures, basic materials and food, drink and tobacco were all higher than in the previous quarter. Within manufactures, over the same period there was a strong pick up in exports of capital goods, semi manufactures (especially chemicals) and other consumer goods. Exports of cars continued to grow steadily.

6. Although the monthly figures remain erratic, the latest figures provide further evidence that the upward trend in export volumes has resumed following the apparent pause earlier in the year.

7. **Imports**

	percentage change		
	Sept on Aug	Third quarter on previous quarter	Third quarter on same period year earlier
Total value	-5½	7½	14
Total value excl. oil and erratics	-5½	8½	14
Total volume	-3½	7	8½
Total volume excl. oil and erratics	-3½	8	12
Manufactures volume (excl.erratics, OTS basis)	-5	10	13
Fuels volume (OTS)	3	16	-8
Basic materials volume (OTS)	5	-1	14
Food, drink and tobacco volume (OTS)	1	5½	½

8. Import volumes, excluding oil and erratics, fell by 3 per cent in September from the high August level. Imports of manufactures fell but other categories rose. Within manufactures the largest fall recorded was for passenger motor cars (down 27 per cent), but there was a small rise in imports of capital goods.

9. The quarterly path for imports continues to be erratic. However taking the third quarter as a whole, the underlying trend of non-oil import volumes (excluding erratics) seems to be firmly upwards afterthe falls earlier in the year and imports are now above the high level reached in at the end of 1986. In the third quarter the volume of imports (excluding oil and erratics) was about 12 per cent higher than a year ago. Imports of capital goods, intermediate goods and chemicals have grown particularly strongly over this period, reflecting the rise in domestic output and investment.

Geographical area

10. Exports to developed countries rose by 5½ per cent in the third quarter compared to the second quarter reflecting a strong recovery in exports to the US and a rise of 27 per cent in exports to Japan but relatively slow growth in exports to the EC. Exports to developing countries increased by 4 per cent in the third quarter, while exports to oil exporters showed a 3 per cent rise.

Trade prices

percentage change

	Import prices (OTS)		Export prices (OTS)	
	Sept on Aug	Third quarter on previous quarter	Sept on Aug	Third quarter on previous quarter
Manufactures (excl.erratics)	0	½	½	1
Food, drink, tobacco	½	-½	½	½
Basic materials	-1½	½	-½	1½
Fuel	-2	2	-5	5½
Total (BOP basis)	0	1½	0	1
Total less oil(BoP basis)	0	1½	½	1

11. In the third quarter the total terms of trade as measured by unit value indices was unchanged and the non-oil terms of trade deteriorated by ½ per cent compared to the previous quarter. Over the same period the exchange rate has been broadly flat whilst oil prices have risen, offset by a rise in commodity prices. (NB: the published series are unit value indices, which can present a misleading picture over a period of time due to their use of 1980 weights.)

Comparison with Treasury forecasts

NOT FOR USE

12. The out-turn for non-oil import volumes in the third quarter take them above the quarterly levels underlying the published FSBR forecast but broadly in line with those in the internal October

forecast. The out-turn for the volume of non-oil exports is a little higher than in the FSBR and October internal forecasts. The current deficit of £0.8 billion so far this year is smaller than expected at the time of the FSBR and a little smaller than in the October forecast.

Market expectations

13. The market expectation is for a current account deficit of £300-350 million in September. The September deficit is somewhat smaller than expected by the City, and is likely to be received well.

Press briefing

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

PAUL DAVIS
EA2

SECRET AND PERSONAL
UNTIL 11.30 am FRIDAY 23 OCTOBER
THEN UNCLASSIFIED

DRAFT BRIEFING FOR IDT

Positive

~~1. Current account deficit of £55 million in September, £874 million smaller than previous month's deficit.~~

2. Export volumes (excluding oil and erratics) in three months to September 9½ per cent higher than a year earlier.

3. Manufacturing industry performing well. Volume of manufacturing exports (including erratics) 11 per cent higher in third quarter than a year ago. Output up 6 per cent comparing three months to August with a year earlier.

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

Defensive

We ~~constantly say don't make too much of~~ never draw conclusions from one month's figures. But clear that

1. September figures freakishly good. August figures erratically bad. Not surprising there has been significant improvement.

~~2. Current account balance estimate unreliably erratic. Exports and imports both erratic recently. Current account balance of very large flows, have relatively small fluctuations in flows cause relatively large movements in balance. Have always stressed that too much weight should not be put on one month's figures.~~ don't really need — its for DTI/CSO to defend their figs!

3. Current account deficit in 1987Q3 largest ever recorded: Recent figures volatile - third quarter includes erratically high August deficit. Deficit in first three quarters of 1987 only £¾ billion - very small as share of GDP (less than ¼ per cent), much smaller than imbalances in other major countries and smaller than ~~implied by~~ might have been expected given Budget forecast of deficit of £2½ billion for 1987 as a whole.

4. Current deficit widening. Current deficit of £796 million for year so far lower than £1870 million deficit in second half of 1986. Out-turn so far this year still better than expected at Budget time.

5. FSBR forecast of £2½ billion current account deficit in 1987 too optimistic: Out-turn so far this year slightly better than expected. ~~Only modest current deficit in year so far. New forecast to be published at time of Autumn Statement.~~

6. Trend in imports strongly upwards. Recent figures very erratic, but inevitable that there should be some rise in imports as the economy expands. Imports of semi manufactures, capital and intermediate goods reflect rising output and investment, as expected.

7. Imports rising faster than exports [In third quarter on a year earlier, import volumes (excluding oil and erratics) up 12 per cent, compared with 9½ per cent rise for exports. On previous quarter import volumes up 8 per cent while exports up 6 per cent.] Not surprising given that UK economy is growing faster than ~~most~~ all other major economies. ~~which are currently underperforming~~. As growth overseas picks up, UK exports should benefit.

8. Exports no longer growing. In third quarter export volumes (excluding oil and erratics) 9½ per cent higher than same period a year ago. Volume of manufactures exports 11 per cent up over same period to highest level ever recorded.

9. Rise in current account deficit confirms economy overheating? No. Current account deficit on its own does not imply overheating - ~~other evidence suggests little cause for concern.~~ Rather reflects underperformance of rest of world economy.

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

11. Fall in exchange rate needed - sterling's recent strength threatens competitiveness: Not at all. ~~Competitiveness remains 10 per cent better than average in 1984 and 1985.~~ Period of stability in exchange rate ~~now~~ desirable - sentiment endorsed by CBI. ~~G7 confirmed in Washington that currencies are within ranges consistent with fundamentals.~~

12. Invisibles projections for July and August and September imply fall from 1987Q2 surplus. (Q3 out-turn to be published in December.) Projections based on latest but incomplete information. Surplus of £2187 million in 1987Q2 reflected substantial improvement but too soon to say whether it reflects rise in strong underlying invisibles balance. UK invisibles surplus in 1986 largest in world.

13. Official statistics understate strength of UK current account performance. [Phillips & Drew article 'Lies, Damn Lies and Invisible Statistics' published 8 October 1987, alleged current account may actually be in surplus in 1987 so far and in previous years due to underrecording of invisible exports following ending of exchange controls.] True that growth in securitised market makes apportioning of portfolio earnings more difficult. Balance of payments balancing item rose to £11.7 billion in 1986 reflecting either unrecorded net current account credits or net capital inflows. Would not be surprising if some errors in current account. !!

TRADE FIGURES FOR AUGUST 1987

Advance circulation

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

Circulation after 11.30 am on Thursday 24 September

Paymaster General
Mr Monck
Mr Matthews
Mr Patterson
Mr Tyrie
Miss Roche - No.10

SECRET AND PERSONAL
UNTIL 11.30 am TUESDAY 24 NOVEMBER
THEN CONFIDENTIAL

Ch content with briefing? mpw

FROM: PAUL DAVIS
DATE: 20 NOVEMBER 1987

cc: See attached list

CHANCELLOR OF THE EXCHEQUER

OK

OCTOBER TRADE FIGURES

The October trade figures will be published at 11.30 am on Tuesday 24 November. They will show a deficit on visible trade of £882 million. Combined with an unchanged CSO projection of the monthly invisibles surplus of £600 million, they give a projected current account deficit of £282 million in October compared to a revised deficit of £17 million in September. In the three months to October the current account was in deficit by £1206 million while in the first ten months of the year, the current account deficit was £1053 million.

Main points

2. **Current account** £ million

	1986 Year	Q3	Q4	1987 Q1	Q2	Q3	Aug	Sept	Oct
Manufactures	-5491	-1741	-1826	-736	-1874	-2165	-1254	-282	-734
Oil	4056	621	785	1164	1033	945	372	286	386
Other goods	-7028	-1771	-1684	-1563	-1541	-1828	-625	-621	-534
Total visibles	-8463	-2891	-2725	-1135	-2382	-3048	-1507	-617	-882
Invisibles	7483	1981	1765	1807	2187	1800*	600*	600*	600*
Current balance	-980	-910	-960	672	-195	-1248*	-907*	-17*	-282

* Invisibles figures since July are projections

3. The value of exports fell by £0.2 billion between September and October and imports rose by £0.1 billion; hence the visible deficit in October was £0.3 billion larger than in September. In the three months to October the visible deficit rose by £0.2 billion to £3.0 billion, reflecting a £0.4 billion rise in the non-oil deficit partly offset by a £0.1 billion rise in the oil surplus. Over the same period the manufacturing trade deficit widened by around £0.2 billion to £2.3 billion.

4. **Exports**

	percentage change		
	Oct on Sept	latest three months on previous three months	Latest three months on same period year earlier
Total value	-2½	4½	14
Total value excl. oil and erratics	-5½	4½	12
Total volume	-1½	4	6½
Total volume excl. oil and erratics	-5	4	8
Manufactures volume (excl.erratics, OTS basis)	-4	6½	11
Fuels volume (OTS)	7½	6	-3
Basic materials volume (OTS)	-11	5½	-2
Food, drink and tobacco volume (OTS)	6	6½	-4

5. Export volumes, excluding oil and erratics, fell by 5 per cent in October, reversing some of the increase in September. The decline largely reflected falls in the export of manufactures and basic materials. In the three months to October volumes of each of the main categories of exports were higher than in the previous three months. Within manufactures, strong growth was maintained in exports of chemicals capital and intermediate goods while exports of cars and other consumer goods continued to grow steadily.

6. Although the monthly figures remain erratic, they show that the upward trend in export volumes is continuing following the apparent pause early in the year.

7. Imports

	percentage change		
	Oct on Sept	Three months to October on previous three months	Three months to October on same period year earlier
Total value	1½	5	13
Total value excl. oil and erratics	½	5½	13
Total volume	-½	5	8
Total volume excl. oil and erratics	-1	5½	12
Manufactures volume (excl.erratics, OTS basis)	2½	7½	14
Fuels volume (OTS)	-14	11	-12
Basic materials volume (OTS)	-4½	-3	13
Food, drink and tobacco volume (OTS)	-4½	2	3

8. Import volumes, excluding oil and erratics, fell by 1 per cent in October. Imports of manufactures, particularly intermediate goods, rose but other categories fell.

9. The path of imports continues to be erratic. Although the volume (excluding oil and erratics) has fallen in the last two months the evidence continues to suggest a strong underlying upward trend in imports after the falls earlier in the year. In the three months to October the volume of non-oil imports (excluding erratics) was 12 per cent higher than a year ago. Over this period there were strong rises in intermediate goods, semi-manufactures and capital goods, reflecting the continuing rise in domestic output and investment.

Geographical area

10. Exports to developed countries rose by 7 per cent in the three month to October compared to the previous three months reflecting strong growth in exports to Japan, a recovery in exports to the USA and a rise of 7½ per cent in exports to the EC. Exports to

developing countries increased by 3 per cent over this period, while exports to oil exporters showed a 12 per cent rise.

Trade prices

	percentage change			
	Import prices (OTS)		Export prices (OTS)	
	Oct on Sept	Latest three months on previous quarter	Oct on Sept	Latest three months on previous three months
Manufactures (excl.erratics)	½	1	0	1½
Food, drink, tobacco	-½	-½	0	1
Basic materials	0	½	-1	0
Fuel	0	2½	-1½	4½
Total (BOP basis)	0	1½	0	1½
Total less oil (BoP basis)	0	1½	0	1½

11. In the three months to October the total and the non-oil terms of trade as measured by unit value indices were unchanged compared to the previous three months. Over the same period the exchange rate and oil prices have been broadly flat but there has been some continued rise in commodity prices. (NB: the published series are unit value indices, which can present a misleading picture over a period of time due to their use of 1980 weights.)

Comparison with Autumn Statement forecast

12. The current account deficit of £1.1 billion in the first ten months of 1987 compares with the Autumn Statement forecast of a deficit of £2½ billion for the year as a whole. Although the outturn so far appears to be rather better than implied by the forecast, there remains considerable scope for data revision (particularly to invisibles) before the first complete estimate of the 1987 current account is published next March. The margins of error must still, therefore, be regarded as substantial.

Market expectations

13. The market expectation is for a current account deficit of around £300 million in October. The October deficit is therefore much as expected by the City, and should give little cause for concern.

Press briefing

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

PAUL DAVIS
EA2

SECRET AND PERSONAL
UNTIL 11.30 am FRIDAY 24 NOVEMBER
THEN UNCLASSIFIED

DRAFT BRIEFING FOR IDT

Positive

1. Export volumes (excluding oil and erratics) in three months to October 8 per cent higher than a year earlier and on firm upward trend. Forecast to rise further in 1988.

2. Manufacturing industry performing well. Volume of manufacturing exports (excluding erratics) 11 per cent higher in three months to October than a year ago. Output up 6 per cent comparing third quarter with a year earlier.

3. CBI Survey for October shows export order books ~~still~~ above normal by biggest margin ever.

Defensive

1. Large current account deficit in latest three months. Recent figures volatile - latest three months includes erratically high August deficit. Deficit in first ten months of 1987 only £1.1 billion - very small as share of GDP (¼ per cent), much smaller than imbalances in other major countries. ~~Figs for first 10 months of 1987 suggest little likelihood of exceed £2½ bn deficit for~~ and well within Budget/AS forecast of £2½ bn deficit for 1987 as a whole.

2. Current account deficit forecast to rise further in 1988. Projected deficit of £3½ billion only ¾ per cent of GDP - much smaller than imbalances in US, Germany and Japan (currently 3-4 per cent of GDP/GNP) and UK deficit in mid 1970s (also 3-4 per cent of GDP).

3. Autumn Statement forecast of £2½ billion current account deficit in 1987 too pessimistic: Forecasts for 1987 still subject to substantial margin of error. Data revisions quite likely before first complete estimate of 1987 current account published next March.

4. Current account deficit no longer "temporary" as Chancellor earlier claimed. Deficit reflects fast growth of UK economy relative to all other major economies. No reason to suppose that deficit will not decline as growth rates converge.

5. Rise in current account deficit confirms economy overheating? No. Current account deficit on its own does not imply overheating. Rather reflects underperformance of rest of world economy.

6. Trend in imports strongly upwards. Recent figures very erratic, but inevitable that there should be some rise in imports as the economy expands. Imports of semi manufactures, capital and intermediate goods reflect rising output and investment, as expected.

7. Imports rising faster than exports [In three months to October on a year earlier, import volumes (excluding oil and erratics) up 12 per cent, compared with 8 per cent rise for exports. On previous three months import volumes up 5½ per cent while exports up 4 per cent.] Not surprising given that UK economy is growing faster than all other major economies. As growth overseas picks up, UK exports should benefit. Import growth should slow in 1988 as UK growth moderates.

8. Fall in exchange rate needed - sterling's recent strength threatens competitiveness: Not at all. Competitiveness remains 10 per cent better than in 1984 and 1985. Period of stability in exchange rate now desirable - sentiment endorsed by CBI.

9. Export growth projected to slow in 1988: UK projected broadly to maintain volume share of total world trade in manufactures, continuing improved performance which has been evident since 1981, following decades of decline.

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

11. <u>Government relying too much on invisibles</u> [Morgan Grenfell economists suggest Autumn Statement forecast too optimistic in light of stock market crash.] Autumn Statement took account of recent movements in financial markets. Falls in securities markets have increased the uncertainties in forecasting, but invisibles to remain in substantial surplus.

12. <u>Effect of stock market fall on investment income.</u> Position has been affected on both sides of account by movements in financial markets and by exchange rate changes but too soon to be precise about effect on net overseas asset position or income ~~form~~ from these assets.
Note that share prices generally back only to end-1986 levels, which is date to which latest published net overseas assets figs relate.

13. <u>Official statistics understate strength of UK current account performance</u>. [Phillips & Drew article 'Lies, Damn Lies and Invisible Statistics' published 8 October 1987, alleged current account may actually be in surplus in 1987 so far and in previous years due to underrecording of invisible exports following ending of exchange controls.] True that growth in securitised market makes apportioning of portfolio earnings more difficult. Balance of payments balancing item rose to £11.7 billion in 1986 reflecting either unrecorded net current account credits or net capital inflows. Would not be surprising if some errors in current account.

TRADE FIGURES FOR OCTOBER 1987

Advance circulation

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

Circulation after 11.30 am on Thursday 24 November

Paymaster General
Mr Monck
Mr Matthews
Mr Patterson
Mr Tyrie
Miss Roche - No.10

Alex

If the thesis in Haschek's paper is that super-liberalised capital flows are disrupting world trade in physical goods and services and thereby generating pressures for protectionism:-

Then the thesis must be assumed to apply to the US dollar which was being held above the level justified by the fundamentals before it peaked in February 1985. Since then it has come down to a level which is probably not too far off the fundamentals on average (though it may have further to fall against particular currencies). This means that spontaneous capital flows are no longer holding the US dollar at too high a level. The danger is that the dollar may fall too fast and overshoot - this could aggravate pressures for protectionism because in the short run the effects of a lower dollar on the US trade balance are negative (the J-curve). Therefore right course is for all major countries to make commitment to hold exchange rates at about current levels for the time being by adopting suitable and co-ordinated domestic policies and international arrangements to promote exchange rate stability (as agreed under the Louvre accord) ~~and~~, for surplus countries to expand domestic demand above potential for a short period and for the US to become more export-oriented.

There is no reason to believe that we need give up the enormous benefit (not disadvantage) of free capital movements - which enable finance to be provided to the most profitable physical investments - just because exchange rates can be volatile. Instruments exist for governments to dampen this volatility and for individual producers to offset its effects through use of the swaps and options markets. The British Government abandoned controls over capital movements in 1979 and provided enormous benefits to multilateral trade, almost certainly reducing pressures for protectionism rather than increasing them by opening up the economy to international competition.

Harry

Next BURNS bilateral.

ps8gf

FROM: **P N SEDGWICK**
DATE: 8 JULY 1986

SEDGWICK to RL 8/7

MRS LOMAX

Ch/
You may want a word with Terry at some stage.
RL
8/7.

yes.

cc Sir P Middleton
Sir T Burns
Mr Monck
Mr Byatt
Mr Evans
Mr Culpin
Mr Mowl
Mr Kelly (EF1)
Mr Carpinter
Mr Kelly (FEU)

THE TRADEABILITY OF MANUFACTURING AND SERVICES

The Chancellor may have noticed that in yesterday's Commons debate on the future of manufacturing industry Mr Butcher of the DTI repeated in if anything more extravagant terms than in February his claim that while 80 per cent of manufacturing industry is tradeable only 18% of services output is tradeable. (I attach a copy of Mr Butcher's speech, together with those by Mr Cecil Parkinson and Mr Roy Jenkins.)

2. After the exchange of letters between the Chancellor and Mr Channon in March and April (copies attached) it was agreed that officials in the Treasury and DTI should try to reach agreement on this issue so that future statements by DTI and Treasury Ministers could be consistent and correct. (We have asked that in the meantime DTI officials advise their Ministers to refrain from using in public 80/18 per cent figures, but to no avail.) It might be helpful if I give a progress report on work so far.

3. With my opposite number in DTI I have been trying to reach agreement on the analysis and figuring. After what seemed a reasonably promising start DTI economically appear to have reverted to what I regard as a quite mistaken line. Among the important points we have discussed are the following.

(i) **<u>The definition of "tradeable"</u>**: The DTI tend to favour a definition that excludes goods and services that have to be produced in the same country in which they are consumed. This rules out for instance expenditure by foreigners in this country on goods and services. Expenditure by visitors of one sort or another represented getting on for 20 per cent of recorded exports of services in the UK in 1984. It is manifestly absurd to have services that are recorded as traded but defined as non-tradeable. The pro-manufacturing bias among DTI officials (including the economists involved in this exercise) does, however, make it difficult for them to accept their line of argument as absurd.

(ii) The DTI analysis (referred to by Mr Butcher in cols. 47 and 48) is not new, though it is being updated for this exercise. They simply calculate the proportion of services gross output that they subjectively judge could potentially be sold directly abroad. No account is taken of the indirect contribution of services to manufacturing exports.

There is in col. 47 of Mr Butcher's speech what I assume to be a covert swipe at us when he says that this work has been "rechecked and compared with the work of colleagues in Whitehall". Our main complaint is that its coverage is too narrow for reasons given above.

(iii) It is well known that a substantial proportion of the value of manufactured exports represents the net output of other sectors - the overseas sector (the import content) and the domestic primary and tertiary sectors. While exports of manufactures have a substantial import and services content, exports of services have relatively small import and manufacturing content.

Our own work has suggested that the value of net output of the service sector (widely defined) that is exported is approximately the same as the net output of manufacturing that is exported. These calculations do of course imply that a much higher proportion of net output in manufacturing is exported than in services and that net exports per employee are higher. Nevertheless the difference between the trading performance of the two sectors is less extreme than the DTI calculations - based on the ratios of gross exports to gross sales in particular sectors - suggest.

4. We have never denied that in certain parts of the services sector which currently trade on a relatively modest scale the scope for further significant increases in exports is likely to be modest. Put thus the reservations that some have about the scope for large increases in services trade are a good deal more convincing than a line of argument that denies that particular activities are tradeable when they demonstrably are. It should be possible to agree on this line of argument, that satisfies the legitimate parts of the DTI view, without doing violence to the facts.

5. I think it is worth having one more attempt at my level to reach an agreed position with DTI. Huw Evans - who will be taking over FEU's responsibilities for analysis on international trade in the new international Finance Group - has agreed to take the lead straight away (ie before the new office organisation comes into effect). It would not be sensible to swap under secretaries in the middle of any new discussions. If this attempt shows signs of failing it might be helpful if Sir T Burns or Mr Byatt try to reach an accord with Mr Leisner. If that fails there will be no stopping Mr Butcher and DTI officials.

P.N.S

P N SEDGWICK

CHANCELLOR OF THE EXCHEQUER

What is the latest state of
play (v. unsatisfactory, I
suspect, so far as I recall,
despite all Mr Sedgwick's
efforts) over the DTI's
absurd claim that only
18% of services (as against
80% of manufacturing output) are
internationally tradeable?
I raise this again because
I see that Saturday's ~~FT~~
~~leader is a particularly~~
~~stupid~~ crass FT leader
has again plugged this so-
called 'fact'. If we cannot
get DTI to change their tune,
we must clearly outflank
them. Let us look rationally @

over

The foreign exchange earned
by (a) mfg & (b) services.
What is relevant here is, of
course, the net foreign exchange -
i.e. after deducting in each
case the cost of imported
inputs. Pse let me have
these figs ASAP?

M

Mr Marks.
X must be worth trying: means a outflanking spch by me and/or EPR outside - pass soon.
N.

FROM: **P N SEDGWICK**
DATE: 11 SEPTEMBER 1986

CHANCELLOR

cc Sir P Middleton
Sir T Burns
Mr Byatt
Mr Monck
Mr Evans
Mr Culpin
Mr Kelly (IF2)
Mr Owen

Ch
(1) Para 1-5 take a long time to say "not much progress yet"
(2) Could work material (including value-added figures in this note) into a speech, perhaps together with changing trends in import penetration, if suitable opportunity can be found. Will pass to Andrew if you are attracted to that.
AA

Yes poss — key figs cd. perhaps be worked into my spch in debate on Queen's spch in Nov; but not prepared to have it away for Man Ho in Oct.
N.

TRADEABILITY OF MANUFACTURING AND SERVICES

In his minute to me of September 1 Mr Allan passed on your enquiries about the latest state of play on our discussions with DTI on this issue. My note to Mrs Lomax of 8 July (copy attached - see paragraphs 3 and 4) set out the progress (or lack of it) to that date on the part of officials in the Treasury and DTI to find common ground on the relative contributions of manufacturing and services to overseas trade.

2. The initial remit from Ministers to officials followed statements by Mr Butcher in February. My note to Mrs Lomax followed some more extravagant remarks by Mr Butcher in the House of Commons in July. Your latest enquiry followed the FT leader of August 30. It is worth noting that the tone of the FT leader ("In a sense the Aldington argument has been won....") contrasts sharply with Sam Brittan's article at the time of the publication of the House of Lords report on overseas trade. I gather that Sam Brittan was away at the time and was unaware that this leader had appeared when taxed about it on his return.

3. In my minute to Mrs Lomax I outlined the difficulties we were having with DTI officials, notably with arbitrary statistical techniques and a definition of tradeability that together imply that services do not contribute much to trade. Since then there has been another meeting with DTI officials in an attempt to

persuade them to broaden their analysis and to adopt a more balanced view of the actual and prospective role of services in international trade. As a result we are somewhat more optimistic about eventually reaching an agreed line, but past experience shows that they could still disappoint us.

4. We are due to receive and discuss a DTI paper next week. This should take account of our views and some figuring that we have sent them (discussed in paragraph 7 below) as well as provide a detailed description of their own odd analysis that supposedly underlies the public assertion that only 20 per cent of services are tradeable in contrast to 80 per cent for manufactures. The aim is that after discussion of the DTI paper there should be a jointly agreed paper that sets out all the available analysis and ends with some policy conclusions. This would go to Treasury and DTI Ministers, though with each set of officials submitting the paper separately to their Ministers.

5. It is quite possible that there will not be sufficient consensus among Treasury and DTI officials for it to be possible for the paper to be jointly agreed. Before finally accepting such an outcome we would want to follow the suggestion of Sir P Middleton (Mr Murphy's minute to Sir T Burns of July 10 - copy attached) and see if discussion at a higher level with Sir T Burns and, presumably, Mr Leisner of the DTI could produce a reasonable measure of agreement.

X

6. If that failed it would then be appropriate to consider, as you have suggested, some measures to outflank the DTI. I am not sure precisely what you have in mind. Because of his belief in the preeminent role of manufacturing in wealth creation and overseas trade Mr Butcher will from time to time, largely I believe unprompted by DTI officials, repeat his views in public. To outflank him you could take some or all of the following steps,

(a) talk to Mr Channon and try to agree a broad public line on this topic, possibly taking relevant parts of the DTI press note on the Aldington Report and the government's official response - both drafted jointly by the Treasury and DTI - as a starting point,

(b) make a speech during the autumn that gives a more balanced and better founded view of the importance of the two sectors,

and (c) publish an article, possibly in the EPR, that sets out the detailed material that underpins our views on the relative importance of the two sectors: the article would try to perform a similar role to the EPR article in 1985 that at an earlier stage in this debate performed a useful role in showing, inter alia, the extent to which the decline in manufacturing as a share in GDP was a worldwide phenomenon.

7. Finally Mr Allan's note asked for material on the relative foreign exchange earnings of manufacturing and services, and in particular the net foreign exchange earnings after deducting in each case the cost of imported inputs. We incorporated a good deal of relevant material on this in a detailed paper that we put to DTI officials in the summer. In our material for the DTI we showed the net output or value added in each sector that is exported (either directly or indirectly). To estimate the value added for export of a particular sector it is necessary to take account not just of imported inputs, as you suggest, but in addition of inputs from other domestic sectors. The absolute amounts of value added exported by manufacturing and services were much closer in 1979 (the last year for which we have detailed input-output data) than examination of gross export data suggests. (See the attached table.) Gross direct exports of services and manufactures accounted for about 23 per cent and 60 per cent respectively of the gross value of total exports in 1979. But breaking this total down in terms of the original source of value added we see that about 25 per cent was generated in services and only slightly more, 31 per cent, in manufacturing (with a further 26 per cent attributable to imports and the rest to the primary and energy sectors).

8. These data show also that the share of value added in each sector that was ultimately exported in 1979 was 23 per cent for services and 38 per cent for manufacturing. If these proportions had remained constant between 1979 and 1985, then given that growth of net output or value added in services has been significantly higher than in manufacturing over this period, it would be not unreasonable to conclude that in absolute terms the direct and indirect value added contribution of services to exports could well be on a par with that of manufacturing.

9. Thus looked at in these more appropriate ways described in paragraphs 7 and 8 the relative importance of the two sectors in the UK's trade is very different from that suggested by either gross trade flows or the 80/20 tradeable split emphasised by Mr Butcher.

10. We will keep you in touch with developments during the next few weeks.

P.N.S

P N SEDGWICK

1979 INPUT-OUTPUT DATA

	Share in gross value of total exports	Composition of Gross value of total exports in terms of original source of value added
Manufacturing	60.4%	30.8%
Services (excluding public) admin. etc	23.4%	25.2%
Imports*	2.2%	25.6%
Primary, Energy and Other	14.0%	18.4%
Total	100%	100%

* re exports

	The proportion of each sector's total value added ultimately exported
Manufacturing	37.7%
Services (excluding public)	23.1%
Imports	25.8%
Primary, Energy and Other	10.6%

FROM: P G F DAVIS
DATE: 29 DECEMBER 1986

1. Meena

CHANCELLOR

Thanks.

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Sir P Middleton
Sir G Littler
Mr Lavelle
Mr Mountfield (or)
Mr H Evans
Mr Edwards
Mr Bonney
Mr Redley (or)

2. Andrew — see (x)

EC-US TRADE DISPUTE

In his letter to Sir Geoffrey Howe dated 17 December, below Mr Channon reports on the prospect - of which I think you are already aware - that a "trade war" is likely to begin with the US early in the new year. Sir Geoffrey Howe's reply, which differs only on details of how to resolve the dispute, is dated 19 December. Both are attached. There seems no need for you to intervene at this stage. Tactics will need to be considered again when the position of the US administration becomes clearer early in January. At this stage you might simply take note.

2. The gap between the two sides after 6 months of negotiations in GATT remains wide. The EC best offer is 1.6m tonnes for reduced-levy quotas on maize imports as against a US claim of 4m tonnes. The US administration is likely to announce trade measures on 1 January which assert its claim to that amount of compensation. Details will be filled in by the middle of the month, but the measures will probably not begin to take effect until the end of January. So there is in principle time for further negotiations. But the current best guess by the FCO and DTI, taking account of the political climate in Washington and attitudes within the EC, is that the chance of achieving a settlement before the first round of EC retaliation (in DTI terms, the "second strike") has taken place - probably early February - are less than even.

3. Attempts will however be made. The major opposition to concessions from the EC side comes from the French who have the main exporting interest in animal feeds within the Community. The US list of trade measures already published - though as yet without quantities - suggests that UK drinks exports may be affected. But the administration is likely to concentrate its measures on potential southern European supporters of France such as Italy in order to undermine the European position. This is likely to be counter-productive, at least in the first stages of the dispute.

4. Mr Channon's suggestion on both the targets and levels of EC retaliation seems sound enough, particularly his suggestion that the "equivalent" level should acknowledge the validity of the US claim, albeit for lesser quantities than the US are claiming. In paragraph 5 of his letter, Sir Geoffrey Howe rightly points out that emphasis should be put initially on solving the disputes directly between the parties rather than by reference to the GATT arbitration machinery. The US are unlikely to find arbitration acceptable in the early stages anyway. But there are useful precedents for the resolution of US-EC trade disputes by arbitration. Mr Channon will therefore keep this possibility in mind as well.

5. DTI officials think it unlikely that Mr Channon will want to consult colleagues again, at least until the shape of a possible settlement emerges. However there are likely to be regular reports to the weekly meetings of Cabinet.

Peter Davis

P G F DAVIS

2516D

18.12.86

MR FLEMMING 14/12

cc PPS
PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir T Burns
Sir G Littler
Mr Cassell
Mr Lavelle
Mr H P Evans
Mr Peretz
Mr Scholar
Mr S Matthews
Mr Cropper
Mr Ross Goobey
Mr Tyrie

Copies to Mr Loehnis
Mr George
Mr Walker
Mr Cooke
Mr Quinn
Mr Gill
Mr Anderson
Mr Barnes
Mr Kirby
Mr Kent
Mr Gilchrist
Mr Price
Mr C T Taylor
Mr Beverly
Mr D W Green
Mr Warland
Mr Enoch
Mr Page
Mr Saville
Group 1

Given to Sir P Middleton by Mr Flemming at the monetary meeting 22/12

KH

PROTECTIONIST PRESSURES IN THE UNITED STATES

Attached, as requested, is a note which looks at protectionist pressures in the US and discusses the prospects for trade legislation in the 100th Congress.

Somewhat Panglossian, I fear. But the Democrats will move slowly: they will try & extract as much as they can from the Iran affair before switching the focus to protection. M.

International Division, HO-3
18 December 1986

S R Iles (4825)

SRI.

PF 19/1-3

Introduction

1 The United States mid-term elections resulted in the Democrats gaining control of the Senate, probably by a wider margin than had been expected. At the same time the Democrat majority in the House was little changed. The Boesky insider trading scandal and US sales of arms to Iran have further modified the balance of political advantage. These changes in political balance have led to considerable media speculation that protectionist trade measures will be high on the agenda for the 100th Congress. The US Administration appears to have made a similar assessment and has said that it will now cooperate with Congress in order to craft moderate legislation rather than become involved in confrontation. Indeed, press reports today suggest that the Administration will propose its own omnibus trade legislation.

The US current account imbalance

2 The question of whether or not any improvement is beginning to occur in the US trade deficit is a crucial one in the context of the extent of protectionist pressure which might emanate from the newly constituted Congress. There is some evidence to suggest that the deficit has narrowed slightly since the middle of the year when imports were abnormally high, and some encouragement can be taken in the level of exports achieved in the autumn. However, this improvement is, at best, small and, on a balance of payments basis, the deficit rose again in the third quarter.

3 Despite some possible modest improvement in recent months the United States current account imbalance is expected to persist over the next few years at a yearly rate well in excess of US $100 billion. While in nominal dollar terms the large deficit is expected to continue for some considerable time, many forecasters now consider that a slight decline in US import volumes may occur over the next 18 months to 2 years and that there may be some substantial growth in the volume of United States exports. If they occur, these changes will mute, though perhaps not considerably, the current strong protectionist pressures in the

US. The exchange rate changes which have occurred since February 1985, in fact, argue for a fairly sizeable improvement in the US trade account (although many would argue that further depreciation is necessary).

4 On the other hand, it is likely that non-price factors have become more important than in the past and it now seems to be widely agreed that the US manufacturing base is not producing the goods which American consumers demand. There are several further arguments which suggest that the improvement of the US trade account may be slower than if predicted simply on the basis of past performance. The pricing behaviour of foreign exporters, particularly Japanese, to the US is a major uncertainty as, at least so far, they appear to have been willing to accept substantial reductions in profit margins in order to maintain market share. However, it is not clear how long this can continue. Secondly, there are considerable questions about US price competitiveness against a number of Latin American, and Pacific Rim countries, as well as against Canada (all countries which trade heavily with the US.) Finally, agricultural exports are not likely to regain their share of world markets seen at the beginning of this decade. Even if there is an aggregate improvement in the trade balance some areas of industry will still remain in difficulty for structural reasons and vested interests will continue to call for protection.

The 1986 House trade bill

5 Increasingly realization of the complexity of these considerations is, however, beginning to shift the lines of debate. The House trade bill, vetoed by President Reagan earlier this year on the grounds that it would lead to a trade war, will form the background to the hearings in the 100th Congress. Some of the major provisions of this bill are set out below:

(i) It required the President to take retaliatory action, through lower import quotas or higher tariffs, against unfair foreign trade practices that were found to harm US firms (and appeared to take away the authority of the President to reject recommendations from the US International Trade Commission).

(ii) It required countries with an excessive trade surplus with the United States to reduce their surplus by 10% a year for 4 years or face retaliation. The countries effected were West Germany, Japan and Taiwan but, South Korea and Brazil were both, in addition, said to be nearing the level set as excessive in the bill.

(iii) US industry would be able to seek relief against foreign subsidies of natural resources such as timber and agriculture that are exported in competition with similar US products.

(iv) The targetting of certain industries by other countries would be a basis for US firms to seek relief from foreign unfair trade practices (and retraining of workers, whose jobs were displaced by imports, was to be subsidised).

(v) US trademark, patent and copyright protection would be strengthened.

(vi) The Administration would be required to lift export controls over a period of 3 years on 40% of the high technology goods currently restricted from sales overseas.

(vii) The bill attempted to foster stabilisation policy in the foreign currency markets by creating a strategic currency reserve for intervention to keep the dollar at a competitive level.

(viii) The denial of certain internationally recognised rights of workers (including child labour laws, health and safety laws and labour bargaining regulations) would be regarded as unreasonable trade practices.

The Democrat strategy

6 The Democrat success in the mid-term elections has given them control of the legislative machinery on Capitol Hill, but with only few exceptions the new majority has a decidedly centrist look (with most of the newly elected Democrat Senators from conservative southern and western states). The Chairman of the Senate Finance Committee, Lloyd Bentsen, a Democrat from Texas will be responsible for delivering the leadership's pledge to put international trade at the top of the legislative agenda. So far Bentsen has not made known his precise views on the likely form of any trade legislation in the 100th congress. However, he has announced that he will be holding hearings on trade in February and hopes to have a bill through the Senate by the early summer of 1987. (As Chairman of the Joint Economic Committee in the late 1970s he was mostly known for his supply side views and, in particular, the espousal of tax cuts aimed at boosting savings and investment.) During the debate for the 1986 trade bill, which was vetoed by President Reagan, Bentsen advocated a 25% surcharge on imports from countries that enjoyed large trade surpluses with the United States. However, he is not considered as rigidly protectionist as his remarks and the draft legislation implied and his aides now say that he was only applying pressure for the enforcement of existing trade laws and freer markets. In general terms Bentsen has said that his trade aims will include "knocking down protectionist barriers in other countries" and retaliating against "this targetting of our industries by competitors" that are owned or heavily subsidised by foreign governments. The objective is, thus, said to be to vest the President with the authority to respond to such practices "and in effect mandate that he does something about that".

7 In contrast to Bentsen, the new Speaker of the House of Representatives, Jim Wright, is said to be planning a trade bill which will be similar to that which the House passed earlier in 1986. There are, however, strong arguments which militate against such a bill being approved by Congress. The fairly wide-spread view amongst Democrats is that narrow protectionism is a dangerous policy which could well backfire and one which did

Presidential candidate Walter Mondale no good at all in the 1984 election. It is, therefore, unlikely that the Democrats will wish to be labelled protectionist in the run up to the elections in 1988. Moreover, if the Democrats were to pursue the objective of a narrow protectionist trade bill they would be vulnerable to the charge that they were influenced by sectional interest groups such as organised labour.

8 In the light of the above analysis it is likely that the strategy of the Democrats will be to aim for a wide legislative framework which would encompass measures to improve the trade deficit. The main argument put forward would be that the underlying competitiveness of the United States economy has deteriorated considerably in recent years for many reasons, both domestic and external, and that the remedies should similarly be considered on as wide a basis as possible. Accordingly, a new trade bill might well include proposals to improve the quality of education, in particular to boost mathematics, science and language studies (and perhaps engineering) all of which are deemed to have been neglected in recent years. Some increased help for research in areas where foreign penetration is high, and possibly tax incentives for specific industries are other suggestions which may be incorporated in a bill. In addition, it has been suggested that future trade legislation might include provisions of the kind proposed by Senator Bradley on third world debt issues-on the grounds that inadequate growth in heavily indebted countries is one cause of poor US export performance. Financial legislation might (just) also be included on similar arguments, and include some 'guidance' for the Fed on intervention policy. Such a course would be an only thinly veiled attack on the macroeconomic policies of the Reagan Administration.

The Administration response

9 The Reagan Administration has responded to the shift in the political balance first by agreeing to help prepare responsible legislation with the leaders of the 100th Congress "to enhance the international competitiveness of the United States without resorting to protection" and, within the last 24 hours, by

proposing to put forward their own legislation. The argument behind the Administration shift in policy is that by cooperating with Congress they will be able to shape the new trade legislation in much the same way that the Democrats embraced the President's tax reform legislation in 1986 and were able to claim equal credit when it became law.

10 The objective of the Administration during the long run up to the Presidential election in 1988, therefore, appears to be one of containment of the protectionist pressures in Congress and acceptance that some broad legislation is, in any case, necessary. There may be considerable advantages to such a course. Cooperation with Congress would inhibit Democrat efforts to curb the President's authority in administering trade laws and enable the Administration to retain the initiative on the international trade front by pursuing wide ranging bilateral and multilateral agreements eg with Canada, the new GATT round (while continuing to press selective trade disputes vigorously). A collaborative approach would also encourage a renewal of the Congressional authority which is needed to negotiate trade agreements. It would therefore allow effective US participation in the new GATT round.

Conclusion

11 The mid-term elections have, combined with the pressures on President Reagan following the sales of US arms to Iran, increased very substantially the likelihood of protectionist legislation in the 100th Congress. Nevertheless, the Democrats are well aware of the dangers of narrow protectionism including retaliation by other countries and understand that the issues are complex. It is therefore likely that any new legislation will focus much more widely on underlying problems of United States competitiveness, including problems of product quality, lack of research, and the perceived failure of the education system to meet modern day needs, as well as pressing for more direct change on the external front.

12 <u>In the current volatile political circumstances in the US it is not yet possible to speculate even broadly on the precise content of the trade legislation that might be proposed in 1987</u>. The wide range of issues which could be included in such an initiative suggest that the debate may continue well into the year and early action remains improbable. 1987 is not an election year. Improvement in the trade figures, if it occurs, will also mitigate the strength of feeling. In the meantime the <u>Administration is likely to continue to pursue selective trade disputes vigorously, at least partly in order to retain the trade initiative on a wider front though their overall macro-economic impact may not be very large, at least in the short run and it may be difficult to assess the precise implications either for the US economy or for the rest of the world. The latest reports suggest that the Administration response has been taken one step further and that their own omnibus trade legislation will cover many of the concerns of the more moderate Democrats, though not the more extreme ones. Nevertheless maverick action is not entirely to be ruled out.</u>

Meena

Pl thank

T.

FROM: M G REDLEY
DATE: 29 JANUARY 1987

PS/CHANCELLOR 14/2

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State
Sir P Middleton
Sir G Littler
Sir T Burns
Mr Cassell
Mr Lavelle
Mr Monck
Mr Peretz
Mr Mountfield
Mr A J C Edwards
Mr H Evans
Mr Culpin
Mr Bonney
Mr Mortimer
Mr Davis (or)
Mrs Case
Mr Hudson
Miss Preston

Ch

As you already knew, from Cabinet

AJK 29/1

EC-US TRADE WAR

The settlement of the threatened trade war with the US is likely to be confirmed by COREPER in Brussels this afternoon - just in time. US retaliation affecting US exports of gin and cheese which was to have come into effect tomorrow will probably not now take place. Mrs Chalker will make a statement during the debate on the EC White Paper this afternoon.

2. The proposed deal splits the difference on imports of corn and sorghum. The balancing element of the package is a fairly substantial list of tariff concessions to the US worth Ecu 400m in other areas. UK interests are not substantially involved, and DTI has recommended acceptance. The wider importance of the industrial concessions is that they mark acceptance by the US of the EC argument that "compensation" for trade loss could be given in areas other than those directly affected. The balance of advantage under the deal will be reviewed in 1990.

3. The French are expected to complain about the agricultural aspects of the settlement, and other member states may object

to specific tariff concessions in the balancing package. But DTI expect the EC to settle by tonight.

4. Other positive trade news coming coincidentally with this is that a settlement has also been reached this morning in Geneva on the modalities of the new GATT round. This includes difficult negotiations on arrangements for the agriculture talks.

M G REDLEY

— Explanatory telegram on EC-US settlement attached.

ADVANCE COPIES	FRAME EXTERNAL	22 XEROX COPIES
PS PS/[illegible] [illegible] MR BRAITHWAITE MR RENWICK	RESIDENT CLERK HD/ECD(E) (3) HD/NEWS DEPT HD/ERD HD/ HD/	PLUS FCO (50) Mr Litton .. ECD(E) PA. Congress [illegible]
CABINET OFFICE MR D WILLIAMSON MR JH HOLROYD MR M H JAY MR SHEARER	DTI (VICTORIA STREET) MR R WILLIAMS MR A C HUTTON OT2 MR HOSKER OT2/1 Mr Johnson ITP Mr Cooke OT2	ODA MR P FREEMAN
H M TREASURY MR C D CRABBIE	MAFF PERMANENT SECRETARY Mr Hadley Mr Simmonds	PLUS OGDS

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INFO PRIORITY EUROPEAN COMMUNITY POSTS, UKDEL OECD

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EC-US : XXIV.6

SUMMARY

1. AD REFERENDUM AGREEMENT REACHED AT 0800Z. NO SURPRISES:
- 2 MILLION TONNE LEVY-REDUCED QUOTA ON CORN
- 300,000 TONNE LEVY-REDUCED QUOTA ON SORGHUM
- TARIFF CONCESSIONS ON A TRADE VOLUME OF 400 MECU
- ABANDONMENT OF 15 PERCENT MARKET RESERVATION IN PORTUGAL
- US TO RAISE (BUT NOT ELIMINATE) NON-RESTRICTIVE QUOTAS ON BEER, WINE ETC
- US TO RE-BIND TARIFFS ON GIN ETC, AND NOT TO UNDERTAKE RETALIATORY ACTION
- AGREEMENT TO LAST 4 YEARS. PROVISION FOR REIVIEW IN THE COURSE OF 1990

2. COREPER TO DISCUSS PROBABLY AT 1500Z.

DETAIL

3. FIELDING (COMMISSION) REPORTED, IN THEATRICALLY REASSURING STYLE, TO COMMERCIAL COUNSELLORS THIS MORNING. AN AGREEMENT HAD BEEN REACHED AT 0800Z, AFTER 48 HOURS OF ALMOST CONTINUOUS NEGOTIATION. FIELDING THEN DESCRIBED THE AGREEMENT IN STRAIGHTFORWARD TERMS. TEXTS ARE IN MY 4 IFTS.

MAIZE AND SORGHUM

4. THERE WERE NOW TWO SEPARATE QUOTAS FOR THE TWO PRODUCTS. THE COMMISSION HAD REFUSED TO BUDGE FROM 2 MILLION TONNES FOR CORN. DEDUCTIONS WOULD BE MADE PRO RATA, AND TONNE FOR TONNE FROM BOTH QUOTAS TO TAKE ACCOUNT OF US EXPORTS OF CEREAL SUBSTITUTES (CORN

GLUTEN FEED, CITRUS PELLETS, AND BREWERS DREGS). THE QUOTAS AND THE REDUCTIONS WERE ERGA OMNES (THOUGH IN PRACTICE THE 3 CEREAL SUBSTITUTES CAME LARGELY FROM THE US). INITIALLY, THE COMMISSION WOULD HAVE TO ESTIMATE TRADE IN SUBSTITUTES, THEN ADJUST THE QUOTAS AS ACTUAL TRADE FIGURES BECAME AVAILABLE.

THE PORTUGUESE VOLET

5. A SIDE LETTER FROM DE CLERCQ CONFIRMED THE ABANDONMENT OF THE 15 PERCENT MARKET RESERVATION. IN RETURN, THE US WOULD RAISE, BUT NOT ELIMINATE, SOME OF THE NON-RESTRICTIVE QUOTAS IMPOSED LAST YEAR (BEER, WHITE WINE, CANDY, CHOCOLATE AND APPLE JUICE).

TARIFF CONCESSIONS

6. AGREEMENT ON THESE HAD TAKEN MUCH OF THE TIME. THE US HAD BID FOR 50 PERCENT CUTS IN OVER 40 PRODUCTS. THE FINAL LIST COVERED 24 PRODUCTS AND THE CUTS WRE MOSTLY MODEST. IT COVERED A VOLUME OF US TRADE OF 400 MECUS. THE COMMISSION HAD TRIED TO AVOID ITEMS WHICH WOULD AFFECT THE EC'S INDUSTRIAL COMPETITIVENESS, AND ONES WHICH WERE OF PARTICULAR SENSITIVITY TO ONE OR OTHER MEMBER STATE. THE BURDEN OF SACRIFICE HAD BEEN SPREAD EQUITABLY.

FRAMEWORK TEXT

7. FIELDING DREW ATTENTION TO THE PREAMBLE, WHICH RECOGNISED THAT BOTH SIDES MAINTAINED THEIR POSITION ON THE LEGAL INTERPRETATION OF ARTICLE XXIV.6, AND TO THE REVIEW CLAUSE. THIS PROVIDED FOR A MAJOR REVIEW IN 1990, WHICH WOULD TAKE ACCOUNT OF A VARIETY OF FACTORS. BUT THERE WAS NO COMMITMENT TO CONTINUE THE AGREEMENT AFTER ITS 4-YEAR DURATION. THE EC'S TARIFF CONCESSIONS WOULD BE AUTONOMOUS AND UNBOUND.

8. BOTH PARTIES AGREED THAT THE DEAL CONCLUDED THE XXIV.6 NEGOTIATIONS. THIS WOULD BE NOTIFIED TO GATT IN DUE COURSE. THE US HAD AGREED TO RE-BIND THE TARIFFS THEY UNBOUND IN MAY IN PREPARATION FOR RETALIATION.

9. SEVERAL MEMBER STATES ASKED FIELDING TO GIVE AN OVERALL VALUE TO THE PACKAGE. HE REFUSED. IT WAS TECHNICALLY DIFFICULT, AND POLITICALLY UNWISE, AS IT WOULD APPEAR AS A RECOGNITION OF THE US GATT THESIS.

10. PRESIDENCY EMPHASISED NEED FOR DECISIONS TODAY. COREPER WILL DISCUSS PROBABLY AT 1500Z, WHEN DE CLERCQ WILL REPORT.

HANNAY

YYYY
ADVANCE
SHEPHERD FCO
FITTON FCO
JAY CAB
R WILLIAMS DTI
JOHNSON ITP DTI
COOKE OT2
HADLEY MAFF
SIMMONDS MAFF
MAIN
FRAME EXTERNAL

UCLNAN 6575

NNNN

CONFIDENTIAL

CH/EXCHEQUER

REC.	18 FEB 1987
ACTION	MR P. G. DAVIS 18/2
COPIES TO	CST, FST, EST, MST
	SIR P. MIDDLETON
	SIR G. LITTLER
	MR LAVELLE

MR MOUNTFIELD
MR H.P. EVANS
MR A. EDWARDS
MR BONNEY
MR REDLEY

FCS/87/042

A good letter from Acland. ~~[illegible]~~ PSO (APH)

SECRETARY OF STATE FOR TRADE AND INDUSTRY

Work up material for a [illegible] speech by me [illegible]

Trade Relations with the US

1. Thank you for your letter of 22 January and the enclosed paper by officials (below). The dispute with the US over enlargement may be safely behind us, but further difficulties seem bound to arise. I therefore agree that we need to work out the approach we should adopt. You will have seen the thoughtful contributions from Sir David Hannay and Sir Antony Acland. Their recommendations seem to me to hit the right balance.

Not originally copied to US – now below AWK

2. It is common ground that, as and when disputes arise with the US, our objective is to work for a negotiated solution, through the EC or otherwise depending on the nature of the dispute. The Article XXIV.6 incident has given all too clear a warning of the nature of the alternative - a point I stressed to George Shultz and

which he clearly appreciated. On the evidence of that dispute it was clear that all (including the Americans)our Community partners - including the French, on whom we worked hard bilaterally - shared our aim of solution by negotiation, if that were possible on any reasonably equitable basis. In other words, when we could all see into the abyss, the only sensible course was to draw back.

3. It is also common ground between us that a negotiation should take place within the established framework of multilateral agreements and rules. We do not want to follow the Americans down the path to bilateralism, as in their semi-conductors agreement with the Japanese. We need to encourage our EC partners to make the fullest possible use of GATT procedures. However, while any eventual agreement on agriculture - a focus of so many EC-US differences - will need to be set firmly in a multilateral context, we should also recognise that the way towards such wider agreement in the Uruguay round will need to be paved by attempts to reach some measure of prior understanding between the EC and US - the major players in the game. It will be crucial for the EC and US to work together to solve the problems of agricultural over-production. Reforms in the CAP will not be successful without a parallel effort by

and Japan

the US to rein back surplus production and avoid increasingly high subsidised sales in third markets.

4. Your paper rightly concludes that we must defend our own interests robustly. And I note that both from Brussels and Washington this aspect receives considerable emphasis. Sir Antony Acland's view that much of the problem stems from the Administration's wish to appear tough, rather than from congressional pressures, reinforces my own view that we on our side must also be prepared to be tough. As Sir Antony suggests, this means that we must be ready to threaten retaliation. The GATT and its procedures are not highly respected in Washington. This affects their expectation of how their trading partners will approach a dispute. On the other hand, the prospect that US grain producers might lose the Spanish market both for maize and, in effect, for corn gluten feed as well was readily understood. As Sir Antony says, we need to heed our American friends who advise us to demonstrate that Americans will have to pay a price for protectionism.

NB

5. This combination of willingness to negotiate to the very end plus, when really necessary, the threat of retaliation has also proved to be the key to maintaining the unity of the Council - though the Commission clearly

felt at times that it was not receiving the wholehearted support it needed. I am sure that we can only defend our interests effectively if Commission and Council are seen to be at one.

6. There is certainly scope for improvement in the general EC-US trade relationship, and I note that the Belgian Presidency is looking for suitable mechanisms. But while intensified consultations can help to identify problems at an early stage, I rather share the scepticism Willi de Clercq is reported to have expressed. The disputes arise primarily in response to US domestic political needs, and I doubt if early warning will have decisive effect. But we can certainly support the Belgians: more discussion with the Americans will certainly do no harm. I hope we can also agree to take up the suggestions for practical action to influence US opinion set out in Sir Antony Acland's letter, which respond to the three final conclusions of your paper. We must not let the US have a monopoly of the public argument.

7. I should be ready to instruct officials to work on these ideas with yours. In the meanwhile I am sure that both you and Michael Jopling will use your forthcoming visits to Washington to put across forcefully the theme

that a price has to be paid for protectionism and that the Community will not hesitate to respond if it has to do so.

8. I am sending copies of this minute to the recipients of your letter.

(GEOFFREY HOWE)

Foreign & Commonwealth Office

18 February 1987

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215) ....
(Switchboard) 01-215 7877

Secretary of State for Trade and Industry

9 March 1987

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Dear Nigel

THE TRADEABILITY OF MANUFACTURING AND SERVICES

I understand that we have now both received the report, agreed between our officials, on the tradeability of manufacturing and servies.

I have found this a very clear and useful examination of the contribution of the two sectors to the current account of the balance of payments. The range of quantitative measures set out in the report will help us to present a consistent line when the issues arise; and the report is particularly useful in pointing out the inferences which can and cannot be drawn from the data. I am circulating the report to my Departmental colleagues.

The report breaks some new ground on the concept of tradeability. Judging by the length of time it has taken officials to analyse and agree upon the presentation of this concept it would appear to be a measure which is capable of some misiterpretation; but the report draws the very useful distinction between whether a service is tradeable in the sense that it could enter into international trade and the extent to which it could be traded - proportionate tradeability. As the report concludes, most services are tradeable, but many to a limited degree. This distinction should be useful in helping to lift some of the confusion that has arisen following the discussion of tradeability in the Aldington report.

JF5BTM

We will of course wish to stress that there are substantial opportunities for improved trade performance in both services and manufactures. A successful conclusion of the new GATT round of trade negotiations and the completion of the internal market will provide a more liberal and conducive climate for international trade, especially in services. My Department, together with the Bank of England, are currently looking at the opportunities for a number of service industries which could be opened up by a more open international trade regime in services and the ways in which this liberalisation might best be achieved.

Yours,

Paul

PAUL CHANNON

JF5BTM

999-49

Thanks. You have done a good job on the costs, & I accept X. Pse let me have a copy I can send to Mr C's letter.

FROM: **P N SEDGWICK**
DATE: 9 MARCH 1987

Ch
May like to glance at before TB Whatever - I think "proportionate tradeability" may cause more not less confusion. But para 34 (flagged) is quite helpful. AA

Yes

CHANCELLOR

cc Sir P Middleton
Sir T Burns
Sir G Littler
Mr Monck
Mr Byatt
Mr Evans
Mr Mountfield
Mr Odling-Smee
Mr Culpin
Mr Bottrill
Mr Kelly
Mr Owen

TRADEABILITY OF MANUFACTURING AND SERVICES

I attach a paper on the 'Tradeability of Manufacturing and Services' which has been agreed by DTI and Treasury economists. DTI officials are putting the paper to Mr Channon today. This is the paper which you suggested in your correspondence with Mr Channon in March of last year (copies of the relevant letters attached as Annex A).

and he has now written (letter below)

2. The length of time it has taken to produce this paper reflects the considerable difficulty we have had both in agreeing the underlying analysis and drafting the text with DTI officials. There is no denying that the present paper falls well short of what we wanted and is not the sort of paper we would have written ourselves. That said, it is a very substantial improvement on earlier drafts. Indeed as I pointed out in a note to you of 11 September we reached such an impasse that it looked as if we would not be able to agree a paper at all. There was subsequently a meeting, chaired by Sir T Burns, with Mr Leisner and other DTI economists in December. As a result of a degree of progress made at that meeting, we decided that there was just about enough common ground for us to go ahead and produce an agreed document, as envisaged in your letter to Mr Channon. We are now definitely of the view that we have taken this process as far as is sensible and that further discussion with DTI officials would not result in a better paper. In our most recent discussions with DTI officials we have concentrated on the drafting of the introduction and the summary table (the first five pages).

3. While this is clearly not the paper we would have written ourselves, we have achieved some important gains in our negotiations with DTI which it is useful to have set down in a formally agreed paper.

(i) The origin of the Treasury/DTI dispute on the relative importance of manufacturing and services in UK trade was the use by DTI Ministers of the claim that while 80 per cent of manufacturing output was tradeable the equivalent figure for services was 20 per cent.

Since in one way or another nearly all services are actually traded - albeit in some cases on an extremely modest scale - it seemed to us odd that some service output was classified as non-tradeable while recorded as being traded.

As the attached paper makes clear (paragraphs 19 to 22) what DTI Ministers and officials have referred to as "tradeability" when propounding the 80/20 numbers has been another concept altogether, namely the extent to which output might be traded in the foreseeable future. For want of a better label the attached paper refers to this as "proportionate tradeability". (Para 22). We have never disputed the proposition that in practice the proportion of total gross sales for service industries on average that go directly abroad is unlikely to be as high as for manufacturing industry. We have, however, taken exception to the implicit or explicit inferences that they have drawn from these not very illuminating calculations to the effect that manufacturing is in the region of four times as important as services in trade.

(ii) The paper as now drafted accepts that the most useful figures on the relative importance of manufacturing and services in trade are those for goods and services actually traded rather than the very arbitrary estimates of "proportionate tradeability" discussed in (i) above. (See paras 2 to 6 of the summary.)

(iii) At first DTI analysis took little account of indirect exports of services. Only 44 per cent of the average manufacturing good represents value added by the manufacturing sector. Services contribute 16 per cent of the average manufactured good. (The rest comes mainly from imports.) At our instigation therefore the paper gives the same prominence to measures of a sector's value added exported indirectly and directly as it does to measures of gross output directly exported. The former, which show the service sector making a larger relative contribution to trade, were given very little attention in the original DTI drafts.

(iv) The paper shows the absolute values traded by the two sectors as well as the proportion of a sector's output traded. These figures, which were entirely absent from the original DTI drafts, show that the directly and indirectly exported value added of the two sectors are broadly similar, though the proportion of total value added exported by the manufacturing sector is greater than for the service sector. In general, however, the relative contribution of services to trade is greater when the analysis is in terms of the net output/value added of the two sectors rather than gross flows.

(v) The paper shows figures for private services as well as total services. DTI preferred to use only figures for total services, including public services which are largely untraded and likely to remain so. The inclusion of public services reduces the estimates of the proportion of services gross or net output which is exported.

4. The foregoing makes clear that the main cost of agreeing this paper with DTI is that it gives continued currency to the qualitative estimates (80/20) of what the paper now terms 'proportionate tradeability'. These are numbers with which you are familiar and which we all dislike when they are used to buttress unqualified remarks about the absolute tradeability of services. However the description of

these numbers in the paper is heavily qualified and there are clear warnings against drawing conclusions from the apparently relatively high "proportionate tradeability" of manufacturing.

5. The paper is intended as an internal document. There is no plan to make it publicly available and DTI have agreed to consult us should anyone suggest releasing it. We cannot be sure, however, that enthusiastic DTI Ministers and officials will refrain from using those parts of the paper that they like in speeches and briefing. To avoid a potential briefing war you might like to write to Mr Channon to confirm that he has no intention of making the report publicly available, and suggesting that public discussion of the relative importance of manufacturing and services is kept low key. We will provide a draft letter if you want one.

6. If by any chance we do get drawn into public discussion we would suggest basing our position on something like the draft briefing at Annex B.

P.N.S

P N SEDGWICK

FROM: **D W OWEN**
DATE: 12 MARCH 1987

Approved i draft

1. **MR ~~SEDGWICK~~**

2. **CHANCELLOR**

cc Sir P Middleton
Sir T Burns
Sir G Littler
Mr Monck
Mr Byatt
Mr Evans
Mr Mountfield
Mr Odling-Smee
Mr Culpin
Mr Bottrill
Mr Kelly

C/ some suggestions — mainly from Sir T. Content for letter to issue.

CR 13/3

OK as amended in pencil

TRADEABILITY OF MANUFACTURING AND SERVICES

I attach a draft reply to Mr Channon's letter (attached), as requested in Mr Allan's minute to Mr Sedgwick of 10 March.

David Owen

D W OWEN
EA2

Pse
AJR

~~DRAFT~~ **LETTER FROM THE CHANCELLOR TO MR CHANNON**

THE TRADEABILITY OF MANUFACTURING AND SERVICES

Thank you for your letter of 9 March giving your reactions to the paper by officials on the tradeability of manufacturing and services.

I too found the report interesting [and useful]. I hope that following this useful, if protracted exercise, we can present a consistent line in public based on the arguments in the summary of the paper and a balanced use of the figures in the summary table. As you say this should help us to [avoid being involved in sterile public debates of the sort that] clear up some of the confusion that emerged following publication of the Aldington Report.

[You correctly point out] I agree that the concept of tradeability is a difficult one to define[. It is] and even more difficult to measure. [It is therefore helpful to have a detailed account of the analysis behind the figures (80 per cent for manufacturing, 20 per cent for services) - which have already been put into circulation - for the specific concept that you now usefully label 'proportionate tradeability' to distinguish it from the theoretical concept.]

In general I think that there is less scope for misunderstanding and misinterpretation if analysis is primarily based on recorded figures for goods and services actually traded. I was pleased to see that the report did this. // The recorded figures for <u>gross</u> exports and the estimates of tradeability present a rather similar picture of the relative contributions of manufacturing and services, but the recorded data are clearly more firmly based and less open to misinterpretation. The data also show how important it is to take account of indirect exports of services, through inputs to the final products of other sectors, in any assessment of the total contribution of services to UK's trade performance. I was particularly struck by the fact that, when account is taken of indirect exports, the absolute contributions of the two sectors are broadly similar in size. Even so, although, because manufacturing net output is only about half that of services, manufacturing is clearly more intensively traded and likely to remain so in the foreseeable future.

I think all this points to us continuing to emphasise the importance in trade of both manufacturing and service industries and their interdependence. We should draw attention to the vital contribution that greater efficiency in both manufacturing and services can make to the competitiveness of UK manufactured goods. As you say said in the final paragraph of your letter we can point to improved opportunities for trade in both sectors in the future, and I very much welcome the study you mention which you refer to into possible ways of liberalising international trade in services and. I look forward to hearing its recommendations.

Secretary of State for Trade and Industry

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET
Telephone (Direct dialling) 01-215) 5422
GTN 215) ....
(Switchboard) 01-215 7877

9 March 1987

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

CH/EXCHEQUER
REC. 10 MAR 1987
3rd
MR P.N. SEDGWICK 9/3
SIR P MIDDLETON
SIR T BURNS
MR BYATT
MR MONCK
MR EVANS
MR CULPIN
MR C.W. KELLY
MR WYNN OWEN

Dear Nigel

THE TRADEABILITY OF MANUFACTURING AND SERVICES

I understand that we have now both received the report, agreed between our officials, on the tradeability of manufacturing and servies.

I have found this a very clear and useful examination of the contribution of the two sectors to the current account of the balance of payments. The range of quantitative measures set out in the report will help us to present a consistent line when the issues arise; and the report is particularly useful in pointing out the inferences which can and cannot be drawn from the data. I am circulating the report to my Departmental colleagues.

The report breaks some new ground on the concept of tradeability. Judging by the length of time it has taken officials to analyse and agree upon the presentation of this concept it would appear to be a measure which is capable of some misiterpretation; but the report draws the very useful distinction between whether a service is tradeable in the sense that it could enter into international trade and the extent to which it could be traded - proportionate tradeability. As the report concludes, most services are tradeable, but many to a limited degree. This distinction should be useful in helping to lift some of the confusion that has arisen following the discussion of tradeability in the Aldington report.

179/3

JF5BTM

We will of course wish to stress that there are substantial opportunities for improved trade performance in both services and manufactures. A successful conclusion of the new GATT round of trade negotiations and the completion of the internal market will provide a more liberal and conducive climate for international trade, especially in services. My Department, together with the Bank of England, are currently looking at the opportunities for a number of service industries which could be opened up by a more open international trade regime in services and the ways in which this liberalisation might best be achieved.

Yours

Paul

PAUL CHANNON

JF5BTM

MR 9/77

UNCLASSIFIED

FROM: A C S ALLAN
DATE: 10 March 1987

MR SEDGWICK

cc: Sir P Middleton
Sir T Burns
Sir G Littler
Mr Monck
Mr Byatt
Mr Evans
Mr Mountfield
Mr Odling-Smee
Mr Culpin
Mr Bottrill
Mr Kelly
Mr Owen

TRADEABILITY OF MANUFACTURING AND SERVICES

The Chancellor was grateful for your minute of 9 March and thinks you have done a good job in the circumstances. He accepts your view that we have taken this process as far as is sensible and that further discussion with DTI officials would not be fruitful.

2. He would be grateful if you could let him have a draft reply to Mr Channon's letter.

ACSA

A C S ALLAN

SECRET AND PERSONAL until release of press notice at 11.30 am on 23 December 1987 and thereafter unclassified

Ch
Bull point is in last table

	% increases Exports	Imports
Latest 3 months on (a) previous 3 months	5.5	3.0
(b) same 3 months a year ago	10.0	9.0

PS/LV: this needs to come in clearly on press release.

2. I am not quite clear from all this ask re composition of import growth. What do we know & what can we say?

To: MINISTER FOR TRADE Copy No. (3) 27

From: Peter Stibbard
US/S2
V/260 Ext. 4872

18 December 1987

OVERSEAS TRADE FIGURES FOR NOVEMBER 1987

On 15 December I reported the November export figures. The corresponding import figures are now available; they are at a record level (the previous record was in August 1987). However, November exports were at a high level so that the current account deficit at £0.6 billion is below August's record level of £0.9 billion. As usual, we will play down the significance of one month's figures in press briefing, although the impact of these figures will probably be lessened by their release the day before Christmas Eve. As yet, there is no evidence that the flow of trade documents (from which these statistics are derived) has been affected by the coming changes to Customs procedures. These effects are more likely to show up in the figures for December.

Up to the end of November, and taking into account downward revisions to the invisibles surplus published earlier this week by the CSO, the current account deficit for 1987 now stands at £2.1 billion, close to the forecast of £2½ billion published in the Autumn Statement for the whole year. However, later revisions - particularly to estimates of invisible trade - are quite likely.

The usual analysis of the figures follows:

THE CURRENT ACCOUNT

In November, the value of exports was £7.0 billion and imports £8.1 billion, so that visible trade, seasonally adjusted on a balance of payments basis, shows a deficit of £1.2 billion compared with the deficit of £0.9 billion in October.

The Central Statistical Office continue to project a surplus on invisibles of £0.6 billion for months in the fourth quarter so that the current account is provisionally estimated to have been in deficit by £0.6 billion, compared with a provisional estimate of £0.3 billion in October.

Revisions to the CSO estimates of the surplus on invisibles for the first half of 1987 published in their press notice of 15 December amount to a reduction of £100 million and £464 million in the estimates for the first and second quarters respectively.

999-80

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TABLE 1: CURRENT BALANCE, VISIBLE TRADE AND INVISIBLES
(Table 2 of Press Notice)

Seasonally adjusted
Balance of Payments
Basis
£ million

	Current Account Balance	Visible Trade Balances			Invisibles Balance
		Total	Oil	Non-oil	
1985	+2888	-2178	+8104	-10282	+5066
1986	- 944	-8463	+4056	-12519	+7519
1987 June-Aug	-1338	-3180	+ 904	- 4084	+1842
Sept-Nov	- 860A	-2694	+1013	- 3706	+1834A
1987 Sept	+ 17	- 617	+ 286	- 903	+ 634A
Oct	- 282A	- 882	+ 386	- 1268	+ 600A
Nov	- 595A	-1195	+ 341	- 1536	+ 600A
1987 Jan-Nov	-2110A	-8643	+3870	-12512	+6532A

A = Projection or part projection

In the three months ended November there was a deficit on visible trade of £2.7 billion - a surplus on trade in oil of £1.0 billion, offset by a deficit in non-oil trade of £3.7 billion. Between the three months ended August and the latest three months, the visible trade deficit decreased by £0.5 billion; the surplus on oil rose by £0.1 billion while the deficit on non-oil trade fell by £0.4 billion.

EXPORTS

The value of exports in November was £83 million (1 per cent) higher than in October. Exports of oil increased by £16 million between the two months while exports of the erratic items decreased by £82 million. Excluding oil and the erratic items, exports rose by 2½ per cent between October and November.

In the three months ended November, total export volume was 6 per cent higher than in the previous three months and 4½ per cent higher than in the same period last year. Excluding oil and the erratic items, export volume increased by 5 per cent between the three months ended August and the latest three months to stand 6½ per cent up on a year ago. The underlying level of non-oil export volume has been rising steadily since April.

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TABLE 2: EXPORTS BY VALUE AND VOLUME (Tables 1, 4 and 7 of Press Notice)

Bop Basis, Seasonally Adjusted

	VALUE (£m)		VOLUME (1980 = 100)	
	Total	Total Less Oil and erratics	Total	Total less Oil and erratics
1985	78111	57685	118.7	114.9
1986	72843	59238	123.1	117.7
1987 June-Aug	19722	16249	126.9	125.1
Sept-Nov	20852	17100	134.4	131.4
1987 Sept	7034	5858	134.6	134.6
Oct	6867	5546	132.4	127.8
Nov	6951	5696	136.1	131.7

By value, exports of manufactures during the three months ending November were 6½ per cent up on the previous three months; the rises were fairly evenly spread across the main commodity categories.

Also by value, total exports rose by 5½ per cent between the three months ended August and the latest three months. The rise in exports to the developed countries was 8 per cent - within which exports to the rest of the European Community and to North America rose by 8½ per cent and 2 per cent respectively.

IMPORTS

The value of imports in November was £397 million (5 per cent) higher than in October. Imports of oil rose by £62 million while imports of the erratic items decreased by £115 million between the two months. Excluding oil and the erratic items, imports rose by 6½ per cent between October and November.

In the three months ended November, total import volume was 3½ per cent higher than in the previous three months and 7 per cent higher than in the same period last year. Excluding oil and the erratic items import volume rose by 4½ per cent in the latest three months to stand 10 per cent up on a year ago. The underlying level of non-oil import volume has been rising steadily since March but at a faster rate than that of exports.

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TABLE 3: IMPORTS BY VALUE AND VOLUME (Tables 1, 4 and 7 of Press Notice)

Bop Basis, Seasonally Adjusted

	VALUE (£m)		VOLUME (1980 = 100)	
	Total	Total less oil and erratics	Total	Total less oil and erratics
1985	80289	68719	126.0	142.8
1986	81306	73491	134.2	150.9
1987 June-Aug	22902	20786	147.4	167.9
Sept-Nov	23545	21502	152.7	175.2
1987 Sept	7651	7004	150.1	172.1
Oct	7749	7024	149.1	170.7
Nov	8146	7473	158.9	182.8

By value, imports rose by 3 per cent between the three months ended August and the latest three months. Increases over that period in the main categories of manufactures were in the range 5-8 per cent.

Again in value terms, imports from the developed countries rose by 2½ per cent over the latest three months, with arrivals from the European Community countries up by 2½ per cent, from North America up by 5½ per cent and from the other developed countries by 4½ per cent. Imports from the developing countries decreased by 1 per cent between the two three months periods.

TRADE IN MANUFACTURES

Figures showing trade in manufactures on a balance of payments basis will be published in the December edition of the Monthly Review of External Trade Statistics following the release of the press notice. On present estimates they show a deficit in the three months ended November of £2.0 billion compared with a deficit of £2.4 billion in the previous three months. The deficit on trade in manufactures in the first eleven months of this year stands at £6.5 billion compared with a deficit of £4.9 billion in the first eleven months of 1986.

SECRET AND PERSONAL until release of press notice at 11.30 am on 23 December 1987 and thereafter unclassified

TABLE 4: TRADE IN MANUFACTURES (SITC 5-8) (Table 16 of Press Notice, quarterly data only)

£ million
Seasonally Adjusted
Balance of Payments Basis

	Exports	Imports	Balance
1985	52271	55273	-3002
1986	54486	59977	-5491
1987 June-Aug	15045	17447	-2402
Sept-Nov	16046	18026	-1980
1987 Sept	5485	5767	- 282
Oct	5246	5980	- 734
Nov	5315	6279	- 964

COMPARISON BETWEEN AUTUMN STATEMENT FORECAST AND OUTTURN TO DATE

The table below compares the current account for the year to date with the projections for 1987 in Table 1.3 of the Chancellor's Autumn Statement.

£ billion

	Non oil goods		Oil	Invisibles	Current balance
	Manufactures	Other			
1987 Jan-Nov	-6.5	-6.0	+3.9	+6.5	-2.1
1987 year	-7½	-6½	+4	+7½	-2½

PUBLICATION

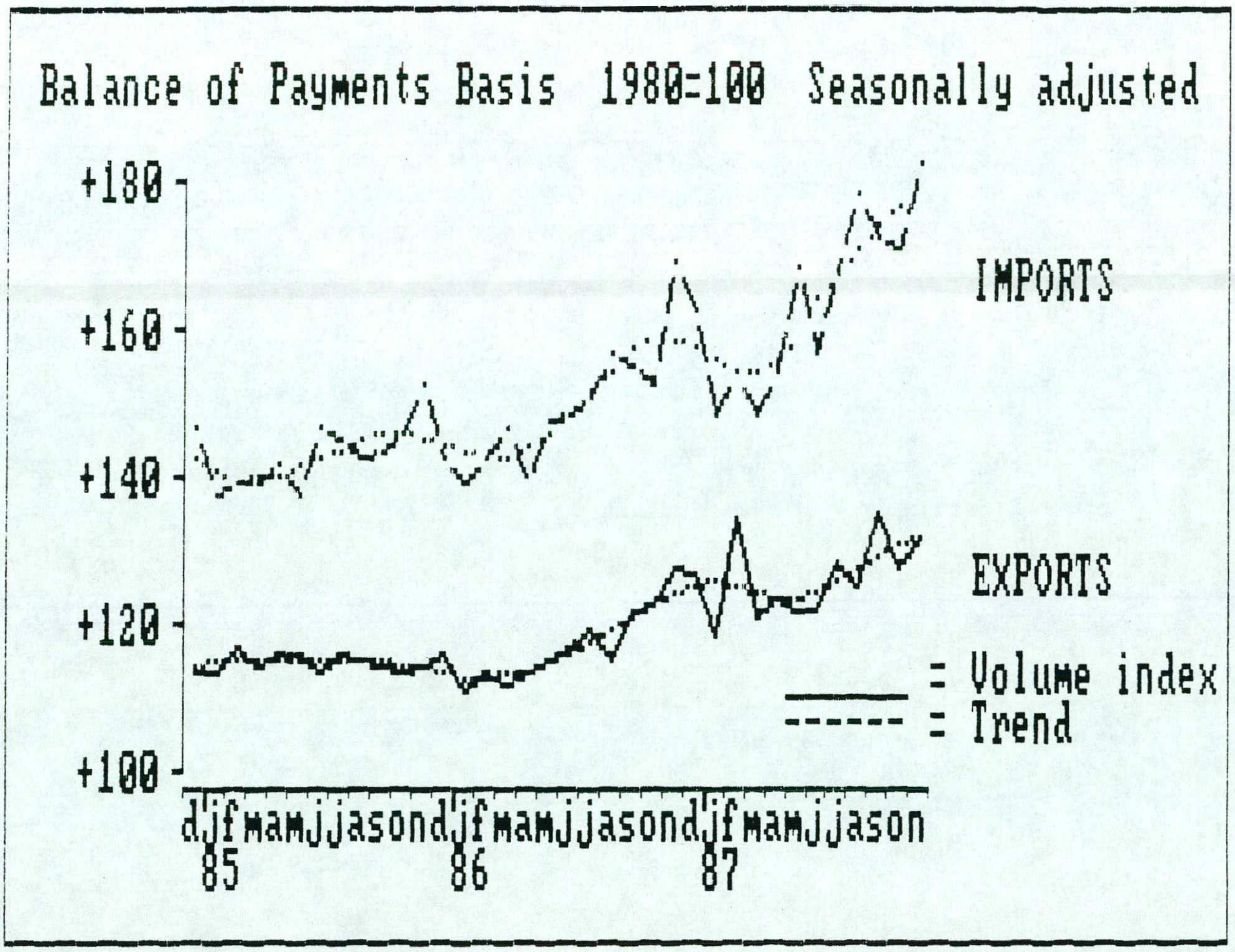
The press notice containing the November figures is scheduled for release on Wednesday 23 December 1987.

P J STIBBARD

999-80

SECRET & PERSONAL UNTIL RELEASE OF PRESS NOTICE ON 23.12.87

VOLUME INDICES EXCLUDING OIL AND THE ERRATIC ITEMS



CIRCULATION LIST

Copy No 1	Minister for Trade	
2	Prime Minister	
3	Chancellor of the Exchequer	
4	Secretary of State for Trade and Industry	
5	Chancellor of the Duchy of Lancaster	
6	Sir Robert Armstrong (Cabinet Office)	
7	Sir Brian Hayes (Dept. of Trade and Industry)	
8	Sir Peter Middleton (HM Treasury)	
9	Governor of the Bank of England	
10	Chairman of the Board of HM Customs & Excise	
11	Mr J Hibbert (CSO)	
12	Mr Pratt (HM Customs & Excise)	
13	Mr B Buckingham (CSO)	
14	Mr Davies (HM Treasury)	
15	Mr P Sedgwick (HM Treasury)	
16	Mr D Owen (HM Treasury)	
17	Mr A McIntyre (CSO)	
18	Mr D J Wilson (Dept. of Energy)	
19	Mr Bottrill (HM Treasury)	
20	Mr H H Liesner)	
21	Mr P J Stibbard)	
22	Mr W E Boyd)	
23	Mr E J Wright)	Dept of Trade and
24	Mrs A Brueton)	Industry
25	Miss C Siddell)	
26	Miss H Chapman)	
27	Mr D Packer)	

Ch/ The usual battle over the description of the underlying trend, I'm afraid. Mr Bottrill knows you will want to object.

Content with briefing for IDT?

We have kept a copy so can take comments by phone

mpw 21/

Spoken

J

[illegible]

SECRET AND PERSONAL
UNTIL 11.30 am WEDNESDAY 23 DECEMBER
THEN CONFIDENTIAL

FROM: PAUL DAVIS
DATE: 21 DECEMBER 1987

DTI statisticians seem determined to be as unhelpful as possible placing excessive reliance on erratic monthly and quarterly figures to present UK trade performance in 1987 in an unhelpful light – in spite of our objections. See paragraph 13 of Mr Davis' note. Do you wish the present dragr changed? If so, are you content with our suggested version? Alternatively, we could seek to delete all adverbs.

ARAB 21/12.

1. MR ~~BOTTRILL~~
2. CHANCELLOR OF THE EXCHEQUER

cc: See attached list

Unacceptable. Spokes–

NOVEMBER TRADE FIGURES

The November trade figures will be published at 11.30 am on Wednesday 23 December. They will show a deficit on visible trade of £1195 million. Combined with an unchanged CSO projection of the monthly invisibles surplus of £600 million, they give a projected current account deficit of £595 million in November compared to a deficit of £282 million in October. In the three months to November the current account was in deficit by £860 million while for the first eleven months of the year, the current account deficit is now estimated at £2110 million.

Main points

2. Current account — £ million

	1986 Year	Q3	Q4	1987 Q1	Q2	Q3	Sept	Oct	Nov
Manufactures	-5491	-1741	-1826	-736	-1874	-2165	-282	-734	-964
Oil	4056	621	785	1164	1033	945	286	386	341
Other goods	-7028	-1771	-1684	-1563	-1541	-1828	-621	-534	-572
Total visibles	-8463	-2891	-2725	-1135	-2382	-3048	-617	-882	-1195
Invisibles	7519	2035	1736	1707	1723	1902	634	600*	600*
Current balance	-944	-856	-989	572	-659	-1146	17	-282	-595

* Invisibles figures since July are projections

3. The value of exports rose by £0.1 billion between October and November and imports rose by £0.4 billion; hence the visible deficit in November was £0.3 billion larger than in October. In the three months to November compared to the previous three months, however, the visible deficit fell by £0.5 billion to £2.7 billion, reflecting a £0.4 billion fall in the non-oil deficit and a £0.1 billion rise in the oil surplus. Over the same period the manufactures trade deficit narrowed by around £0.4 billion to £2 billion.

4. Exports

	Nov on Oct	Latest three months on previous three months	Latest three months on same period year earlier
	percentage change		
Total value	1	5½	10
Total value excl. oil and erratics	2½	5	9½
Total volume	3	6	4½
Total volume excl. oil and erratics	3	5	6½
Manufactures volume (excl.erratics, OTS basis)	1	6½	10
Fuels volume (OTS)	6	5	-4½
Basic materials volume (OTS)	13	-5	-5½
Food, drink and tobacco volume (OTS)	-13	5½	-9

5. Export volumes, excluding oil and erratics, rose by 3 per cent in November, reversing some of the fall in October. This increase reflects rises in exports of manufactures (excluding erratics), fuels and basic materials, although there was a large fall in exports of food. In the three months to November the volume of exports of manufactures grew strongly, to a level 10 per cent higher than a year earlier. There was continued strong growth in exports of capital goods, chemicals and other consumer goods. Exports of non manufactures remain below the high levels recorded at the end of 1986 and in early 1987, though exports of food, drink and tobacco and of fuel have picked up in the last three months.

6. Although the monthly figures remain erratic, they show that the upward trend in export volumes is continuing. In the first eleven months of 1987 export volumes (excluding oil and erratics were 7 per cent higher than the average 1986 level.

7. Imports

	percentage change		
	Nov on Oct	Three months to November on previous three months	Three months to November on same period year earlier
Total value	5	3	9
Total value excl. oil and erratics	6½	3½	10
Total volume	6½	3½	7
Total volume excl. oil and erratics	7	4½	10
Manufactures volume (excl.erratics, OTS basis)	5½	5½	13
Fuels volume (OTS)	5	-2½	-7
Basic materials volume (OTS)	-2½	2½	4½
Food, drink and tobacco volume (OTS)	4½	4	2½

8. Import volumes, excluding oil and erratics, rose by 7 per cent in November. Imports of manufactures rose strongly but there was a fall in imports of basic materials.

9. The path for imports continues to be erratic. The strong underlying upward trend is continuing probably at a slightly faster rate than that of exports: in the first eleven months of 1987 import volumes excluding oil and erratics were 8½ percent higher than the average 1986 level. In the three months to November on a year earlier therehave been strong rises in imports of intermediate goods, semi-manufactures and capital goods have reflected the continuing rise in domestic output, stocks and investment. However, the strongest growth over this period was recorded by consumer goods (excluding cars), up around 18 per cent in response to the growth of retail sales. By contrast, imports of cars have been unchanged as car production has increased.

Geographical area

10. The value of exports to developed countries rose by 8 per cent in the three months to November compared to the previous three months reflecting strong growth in exports to Japan, a continued recovery in exports to the USA and a rise of 8½ per cent in exports to the EC. Exports to developing countries fell by ½ per cent over this period, despite a 6 per cent rise in exports to oil exporting countries.

Trade prices

percentage change

	Import prices (OTS)		Export prices (OTS)	
	Nov on Oct	Latest three months on previous quarter	Nov on Oct	Latest three months on previous three months
Manufactures (excl.erratics)	-½	1	0	1
Food, drink, tobacco	½	-½	-½	½
Basic materials	½	-½	2½	0
Fuel	-1	½	-3½	-2½
Total (BOP basis)	-½	½	-½	½
Total less oil (BoP basis)	-½	1	-½	1

11. In the three months to November the total and the non-oil terms of trade as measured by unit value indices were unchanged compared to the previous three months with a 1 per cent rise in both export and import unit values. Over this period the terms of trade may have been boosted by rises in the exchange rate but this appears to have been offset by the effect of continuing rises in non oil commodity prices and by falls in the oil price. (NB: the published series are unit value indices, which can present a misleading picture over a period of time due to their use of 1980 weights.)

Assessment

12. The current account deficit of £2.1 billion in the first eleven months of 1987 is closely in line with the Autumn Statement forecast of a deficit of £2½ billion for the year as a whole. The first complete 1987 estimate, however, will not be known until March next year, when invisibles for the final quarter will be published together

with revisions to previous quarters. The forecast, therefore, remains subject to a substantial margin of error. Non oil export and import volumes seem likely to rise much as forecast in the Autumn Statement for 1987 as a whole, that is by 7 per cent and 8 per cent respectively.

13. Despite this, DTI statisticians' assessment of recent trends is that imports are currently growing significantly faster than exports. The revised draft press notice includes the following sentences.

> 'The underlying level of non oil export volume has been rising steadily since April.'
>
> 'The underlying level of non oil import volume has been rising steadily since March <u>and at a faster rate than that of exports</u>.'

We have objected to this on the grounds that it relies heavily on comparisons with specific months in early 1987, when the trade figures appear to have been distorted heavily, and it gives a misleading impression of the relative growth of exports and imports between 1986 and 1987.

14. DTI decided to add the underlined section after circulating the first draft of the press notice and despite our objections. We have told them that we will require some amendment to these sentences and would recommend:

> 'The underlying level of non oil export volumes has been rising briskly since the Spring.' ?
>
> 'The underlying level of non oil import volumes has been rising quickly since the Spring.'

no

<u>Market expectations</u>

15. The market expectation is for a current account deficit of around £400 million in November. The November deficit is therefore somewhat larger than anticipated by the City, and there could be a risk of some market reaction in thin trading before Christmas though not of a kind likely to cause us problems in present circumstances.

Press briefing

16. I would be grateful for clearance of the attached press briefing and for your comments on the proposed redraft of the sentences on underlying trends.

PAUL DAVIS
EA2

SECRET AND PERSONAL
UNTIL 11.30 am WEDNESDAY 23 DECEMBER
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DRAFT BRIEFING FOR IDT

Positive

1. Export values up 5½ per cent in three months to November on previous three months whilst imports up 3 per cent. Reflects strength of export volumes which grew by 5 per cent whilst import volumes grew by 4½ per cent over same period. Over past year export values up 10 per cent while imports up 9 per cent.

2. Export volumes (excluding oil and erratics) in three months to November 6½ per cent higher than a year earlier and on firm upward trend. Forecast to rise further in 1988.

3. In three months to November car import volumes down 8 per cent. Over past year car export volumes up 43 per cent, while car imports unchanged. Reflects 16 per cent growth in car production in three months to October on a year ago.

4. Manufacturing industry performing well. Volume of manufacturing exports (excluding erratics) 10 per cent higher in three months to November than a year ago. Output up 6½ per cent comparing three months to October with a year earlier.

5. CBI Survey for December shows export order books still above normal.

Defensive

1. Current account deficit increasing again. Recent figures volatile, never consider one month's figures on their own. In first eleven months of 1987 deficit £2.1 billion after recent CSO revisions to invisibles, within Budget/Autumn Statement forecast of £2½ billion and much smaller as share of GDP than imbalances in other major countries.

2. Current account deficit forecast to rise further in 1988. Projected deficit of £3½ billion only ¾ per cent of GDP - much smaller than imbalances in US, Germany and Japan (currently 3-4 per cent of GDP/GNP) and UK deficit in mid 1970s (also 3-4 per cent of GDP).

3. Current account deficit no longer "temporary" as Chancellor earlier claimed. Deficit reflects fast growth of UK economy relative to all other major economies. No reason to suppose that deficit will not decline as growth rates converge.

4. Rise in current account deficit confirms economy overheating? No. Current account deficit on its own does not imply overheating. Rather reflects underperformance of rest of world economy.

5. Trend in imports strongly upwards. Recent figures very erratic, but inevitable that there should be some rise in imports as the economy expands. Imports of semi manufactures, capital and intermediate goods reflect rising output, stockbuilding and investment, as expected.

6. Imports volumes rising faster than exports over past year. [In three months to November on a year earlier, import volumes (excluding oil and erratics) up 10 per cent, compared with 6½ per cent rise for exports.] Outturns for first eleven months of 1987 consistent with Autumn Statement forecast, which showed non oil import volumes up 8 per cent in 1987 compared with 7 per cent rise in exports.] Not surprising given that UK economy is growing faster than all other major economies. Import growth should slow in 1988 as UK growth moderates.

7. Export growth projected to slow in 1988: UK projected broadly to maintain volume share of total world trade in manufactures, continuing improved performance which has been evident since 1981, following decades of decline.

8. Sterling's recent strength threatens competitiveness - fall in exchange rate needed. Not at all. Competitiveness still better than in 1984 and 1985.

9. Capacity constraint threatens current account performance. Always expected imports to rise as economy grows strongly. Industrialists report capacity utilisation relatively little changed over past year. CBI in latest quarterly survey suggested no widespread evidence of capacity constraint.

10. Why such large downward revisions to current account in first half of 1987? [Invisibles surplus for first half 1987 revised down by £0.6 billion.] Revisions reflect new information on invisibles, especially on services. Estimates based on latest information available, but new information coming in all the time, hence CSO always state most recent quarter provisional.

11. Government relying too much on invisibles [Morgan Grenfell economists suggest Autumn Statement forecast too optimistic in light of stock market crash.] Autumn Statement took account of movements in financial markets. Falls in securities markets have increased the uncertainties in forecasting, but invisibles to remain in substantial surplus.

12. Effect of stock market fall on investment income. Position has been affected on both sides of account by movements in financial markets and by exchange rate changes but too soon to be precise about effect on net overseas asset position or income from these assets. Note that share prices generally back only to end-1986 levels, which is date to which latest published net overseas assets figures relate.

13. UK external position precarious. [Goldman Sachs report, featured in FT 21 December, stated despite large net overseas assets, UK in no better position than previously to weather extended current deficit if this reflects higher consumption rather than increased investment at home.] Not surprising that UK running current account deficit when growing faster than rest of world. Faster growth in rest of world should in time help to contain current deficit. UK domestic investment rising strongly.

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UNTIL 11.30 am WEDNESDAY 23 DECEMBER
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TRADE FIGURES FOR NOVEMBER 1987

Advance circulation

Chancellor
Chief Secretary
Economic Secretary

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

Mr Peretz
Miss O'Mara
Mr Pickford

Mr RIG Allen
Mr Owen
Mr Young

Mr Norgrove - No.10

Circulation after 11.30 am on Tuesday 24 November

Financial Secretary
Paymaster General
Mr Monck
Mr Matthews
Mr Patterson
Mr Tyrie
Miss Roche - No.10

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Mr A Allan
Principal Private Secretary
Chancellor of the Exchequer
H M Treasury
Parliament Street
London
SW1 3AG

21 December 1987

I am attaching a copy of the draft Press Notice on the Current Account of the United Kingdom Balance of Payments in November. The draft was agreed earlier today at the usual interdepartmental meeting.

Publication is set for Wednesday 23 December 1987 at 11.30 am and I should be grateful if you would arrange for the Notice to be cleared by 12.00 noon Tuesday 22 December and to inform me accordingly.

A copy of this letter and draft Press Notice is being sent to Sir Peter Middleton and Mr Davis, H M Treasury.

Yours sincerely

W. E. Boyd

W E BOYD

REVISED DRAFT

COPY 3
No. (21)

SECRET AND PERSONAL until release of Press Notice on 23/12/87 at 11.30 am

NOVEMBER 1987

The current account for November, seasonally adjusted, was estimated to have been in deficit by £595 million compared with a deficit of £282 million in October. In November, exports - seasonally adjusted on a balance of payments basis - were valued at £6951 million and imports at £8146 million so that the trade in goods was in deficit by £1195 million.

The balance on invisibles is projected to be in surplus by £600 million, a large surplus on the transactions of the private sector and public corporations being partly offset by a deficit on Government transactions.

This projection takes account of the latest estimates for the first nine months of the year, published by the Central Statistical Office on 15 December.

SEPTEMBER TO NOVEMBER 1987

In the three months ended November, the current account showed a deficit of £0.9 billion compared with a deficit of £1.3 billion in the previous three months. There was a deficit on visible trade of £2.7 billion in the latest three months compared with a deficit of £3.2 billion in the three months ended August. The surplus on invisibles in the latest three months is projected at £1.8 billion.

CURRENT ACCOUNT

TABLE 1

£ million, Seasonally adjusted

	Current Balance	Visible Trade Balance	Visible Trade Exports fob	Visible Trade Imports fob	Invisibles Balance b
1985	+2888	-2178	78111	80289	+5066
1986	- 944	-8463	72843	81306	+7519
1986 Q3	- 856	-2891	17553	20444	+2035
Q4	- 989	-2725	19340	22065	+1736
1987 Q1	+ 572	-1135	19637	20772	+1707
Q2	- 659	-2382	19388	21770	+1723
Q3	-1146	-3048	20362	23410	+1902
1987 June	- 174	- 748	6394	7142	+ 574
July	- 291	- 925	6762	7686	+ 634
Aug	- 873	-1507	6566	8073	+ 634
Sept	+ 17	- 617	7034	7651	+ 634
Oct	- 282a	- 822	6867	7749	+ 600a
Nov	- 595a	-1195	6951	8146	+ 600a
June-Aug 1987	-1338~~a~~	-3180	19722	22902	+1842~~a~~
Sept-Nov 1987	- 860a	-2694	20852	23545	+1834a
Jan-Nov 1987	-2110a	-8643	73204	81847	+6532a

a Invisibles for October and November 1987 are projections.

b Monthly figures are one third of the appropriate calendar quarter's estimate or projection. Information relating to credits and debits can be found in Table 3.

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VISIBLE TRADE IN NOVEMBER

There was a deficit on visible trade in November of £1195 million compared with a deficit of £882 million in October. The surplus on oil was £341 million, £46 million less than in October. The deficit on non-oil trade increased by £268 million.

Total exports in November were valued at £6951 million, which was £83 million (1 per cent) higher than in October. Exports of oil increased by £16 million and exports of the erratic items decreased by £82 million between the two months. Excluding oil and the erratic items, exports rose by 2½ per cent between October and November.

Total imports were valued at £8146 million in November, which was £397 million (5 per cent) higher than in October. Imports of oil rose by £62 million between the two months and imports of the erratic items fell by £115 million. Excluding oil and the erratic items, imports rose by 6½ per cent between October and November.

RECENT TRENDS

Visible balance

In the three months ended November, there was a deficit on visible trade of £2.7 billion - a surplus on trade in oil of £1.0 billion being offset by a deficit on non-oil trade of £3.7 billion. Between the three months ended August and the latest three months, the deficit on visible trade decreased by £0.5 billion - the surplus on oil rose by £0.1 billion while the deficit on non-oil trade decreased by £0.4 billion.

Exports

Exports amounted to £20.9 billion in the three months ended November, £1.1 billion (5½ per cent) more than in the previous three months. Exports of oil were little changed but exports of the erratic items rose by £0.2 billion. Excluding oil and the erratic items, exports increased by £0.9 billion between the three months ended August and the latest three months.

By volume, exports rose by 6 per cent between the three months ended August and the latest three months to be 4½ per cent higher than the same period a year ago. Excluding oil and the erratic items, export volume increased by 5 per cent in the latest three months to be 6½ per cent higher than in the same period last year. The underlying level of non-oil export volume has been rising steadily since April.

Imports

Total imports were valued at £23.5 billion in the latest three months, £0.6 billion (3 per cent) higher than in the previous three months. Imports of oil fell by £0.1 billion over the three months

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ended November and imports of the erratic items were unchanged. Excluding oil and the erratic items, imports grew by 3½ per cent between the three months ended August and the latest three months.

Total import volume in the latest three months was 3½ per cent higher than in the previous three months and 7 per cent higher than in the same period last year. Excluding oil and the erratic items, import volume rose by 4½ per cent in the latest three months to be 10 per cent higher than in the same period last year. The underlying level of non-oil import volume has been rising steadily since March, initially at a faster rate than that of exports, though more recently ~~than~~ at about the same rate as that of exports.

Terms of trade and unit values

The terms of trade index remained unchanged between the three months ended August and the three months ended November with both the export unit value and the import unit value indices increasing by ½ per cent. Compared with the same three months of last year, the export unit value index rose by 4½ per cent and the import unit value index rose by 2½ per cent. As a result the terms of trade index is 2½ per cent up on a year ago.

Export unit values for fuels fell by 2½ per cent between the three months ended August and the latest three months while the unit value index for non-oil exports rose by 1 per cent. Within the total for non-oil exports, most sectors showed small increases in

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unit values. The largest rises were of 3½ per cent in the unit values of passenger motor cars and of 2 per cent in the unit values of both semi-manufactures excluding chemicals and of other consumer goods.

Import unit values for fuels fell by ½ per cent between the three months ended August and the latest three months and the unit value index for non-oil imports rose by 1 per cent. Import unit values for manufactures rose by 1 per cent over the latest three months; within manufactures unit values both for chemicals and for other consumer goods rose by 2½ per cent.

Analysis by area

Exports to the developed countries rose by 8 per cent between the three months ended August and the latest three months. Exports to the European Community countries rose by 8½ per cent in the latest three months; exports to North America rose by 2 per cent and exports to the other developed countries increased by 15 per cent. Those to the developing countries fell by ½ per cent between the three months ended August and the latest three months.

Imports from the developed countries increased by 2½ per cent over the latest three months with arrivals from the European Community countries up by 2½ per cent, arrivals from North America up 5½ per cent and arrivals from the other developed countries up by 4½ per cent. Imports from the developing countries decreased by 1 per cent between the three months ended August and the latest three months.

NOTES TO EDITORS

INVISIBLES

1 The estimates in tables 1 to 3 incorporate the revised figures which were published in the CSO press notice on the balance of payments accounts on 15 December.

2 Estimates of invisibles are based on a variety of sources, mostly inquiries of those engaging in the various transactions. These are usually sample inquiries, and are variously held on quarterly, annual or periodical bases. For some components, data for recent periods are therefore incomplete and subject to significant estimation errors.

3 The figures shown for the invisibles balance in most months are the estimates for the relevant quarters, taken from the balance of payments accounts, expressed at a monthly rate. For the most recent months, however, the figures are projections, which are rounded to the nearest £100 million to emphasise their approximate nature. These projections are superceded by preliminary estimates from the balance of payments accounts when they are published around the middle of March, June, September and December. (This modifies the procedure described in the December 1986 issue of Economic Trends; a review of the timetable concluded that more time should be allowed to prepare these preliminary estimates to improve their quality and reduce the likelihood of revisions within relatively short periods). Thus the projections for July to September shown in the October Press Notice have been replaced by figures based on the preliminary estimates of the third quarter of 1987, published on 15 December.

ADJUSTMENT FOR UNPROCESSED DOCUMENTS

4 Following a further investigation by Customs and Excise into the effects of industrial action, adjustments have been made to take account of documents delayed from the period April to June and subsequently processed in August and October. These adjustments have been made to the Balance of Payments based figures (tables 1 to 7 and 16), but not to the OTS figures (tables 8 to 15). The amounts involved are as follows:

Adjustment for unprocessed documents

£ million

	April	May	June	August	October
Exports	+30	+71	+67	-18	- 151
Imports	+63	+49	+38		- 150

MONTHLY REVIEW OF EXTERNAL TRADE STATISTICS

5 The Monthly Review supplements the information contained in this Press Notice. It gives longer historical runs of data and contains charts, tables on the UK Balance of Payments, UK exports and imports on an Overseas Trade Statistics basis, and certain international comparisons. The Monthly Review is available from the Department of Trade and Industry at the address given below for an annual subscription of £43 which includes the annual supplement. Individual copies are priced at £3, (£7 for the annual supplement).

AREA (tables 11 and 15)

6 Low value consignments ie items of an individual value less than £475, are not analysed by country and are therefore excluded from the area data in tables 11 and 15. In addition the method of seasonal adjustment leads to further differences between the sum of areas and figures for total trade.

STANDARD NOTES

7 There is a set of standard notes that describe the basis on which the figures in this Press Notice are compiled including the differences between the Balance of Payments (BOP) and the Overseas Trade Statistics (OTS) figures. Copies can be obtained from the address below.

Enquiries about the Standard Notes, and the Monthly Review, should be addressed to S2A, Room 255, Department of Trade and Industry, 1 Victoria Street, London SW1H OET, Telephone: 01-215 4895.

INDEX OF TABLES

CURRENT BALANCE, VISIBLE TRADE AND INVISIBLES
(Balance of Payments basis)

£ million seasonally adjusted

	Current Balance	Visible Trade: Exports fob	Visible Trade: Imports fob	Visible Trade: Visible Balance	of which: Oil	of which: Non-Oil	Invisible Balance [b]
1985	+ 2888	78111	80289	- 2178	+ 8104	- 10282	+ 5066
1986	- 944	72843	81306	- 8463	+ 4056	- 12519	+ 7519
1986 Q3	- 856	17553	20444	- 2891	+ 621	- 3512	+ 2035
Q4	- 989	19340	22065	- 2725	+ 785	- 3510	+ 1736
1987 Q1	+ 572	19637	20772	- 1135	+ 1164	- 2300	+ 1707
Q2	- 659	19388	21770	- 2382	+ 1033	- 3415	+ 1723
Q3	- 1146	20362	23410	- 3048	+ 945	- 3994	+ 1902
1987 March	+ 152	6429	6846	- 417	+ 454	- 870	+ 569
Apr	+ 48	6608	7135	- 527	+ 423	- 950	+ 574
May	- 532	6386	7493	- 1107	+ 365	- 1472	+ 575
June	- 174	6394	7142	- 748	+ 245	- 993	+ 574
July	- 291	6762	7686	- 925	+ 287	- 1212	+ 634
Aug	- 873	6566	8073	- 1507	+ 372	- 1879	+ 634
Sept	+ 17	7034	7651	- 617	+ 286	- 903	+ 634
Oct	- 282a	6867	7749	- 882	+ 386	- 1268	+ 600a
Nov	- 595a	6951	8146	- 1195	+ 341	- 1536	+ 600a
Sept-Nov 1986	- 816	18967	21617	- 2651	+ 780	- 3431	+ 1835
June-Aug 1987	-1338	19722	22902	- 3180	+ 904	- 4084	+ 1842
Sept-Nov 1987	- 860a	20852	23545	- 2694	+ 1013	- 3706	+ 1834a
% Change							
Latest 3 months							
- on previous 3 months		+ 5½	+ 3				
- Same 3 months one year ago		+ 10	+ 9				

a Invisibles for October and November 1987 are projections.

b Monthly figures are one third of the appropriate calendar quarter's estimate or projection.

Table 3

INVISIBLES

£ million seasonally adjusted

	All Sectors: Credits	All Sectors: Debits	All Sectors: Balance	of which: Services	of which: Interest Profits Dividends	of which: Transfers	Private Sector and Public Corporations[d]: Credits	Private Sector and Public Corporations[d]: Debits	Private Sector and Public Corporations[d]: Balance
1984	77080	71223	+ 5857	+ 3489	+ 4207	- 1839	71780	62393	+ 9387
1985	79805	74739	+ 5066	+ 5388	+ 2954	- 3276	75155	64778	+10377
1986	76293	68774	+ 7519	+ 5081	+ 4611	- 2173	71184	59185	+11999
1985 Q3	19358	17630	+ 1728	+ 1501	+ 1109	- 882	18136	14968	+ 3168
Q4	18588	17838	+ 750	+ 1283	+ 207	- 740	17447	15448	+ 1999
1986 Q1	18955	16952	+ 2003	+ 1308	+ 769	- 74	17600	14926	+ 2674
Q2	18464	16719	+ 1745	+ 1205	+ 1106	- 566	17148	14304	+ 2844
Q3	19243	17208	+ 2035	+ 1247	+ 1488	- 700	17966	14679	+ 3287
Q4	19631	17895	+ 1736	+ 1321	+ 1248	- 833	18470	15276	+ 3194
1987 Q1	19730	18023	+ 1707	+ 1256	+ 1304	- 853	18072	14904	+ 3168
Q2	19699	17976	+ 1723	+ 1245	+ 1192	- 714	18237	15170	+ 3067
Q3	20438	18536	+ 1902	+ 1572	+ 1339	- 1009	19160	15550	+ 3610

d ie excluding general Government transactions and all transfers.

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EXPORT AND IMPORT UNIT VALUE AND VOLUME INDEX NUMBERS

Table 4

(Balance of Payments basis)

Indices 1980 = 100

	Unit Value (Not seasonally adjusted)			Volume (seasonally adjusted)	
	Exports	Imports	Terms of Trade[e]	Exports	Imports
1985	143.5	145.2	98.8	118.7	126.0
1986	136.6	134.0	101.9	123.1	134.2
1986 Q3	134.3	130.1	103.2	122.6	139.0
Q4	138.1	136.8	100.9	130.5	144.0
1987 Q1	140.7	140.0	100.5	130.0	133.2
Q2	141.2	136.2	103.7	126.3	140.9
Q3	142.9	137.7	103.8	130.7	151.0
1987 March	141.0	139.8	100.8	126.9	130.2
Apr	141.0	137.2	102.8	131.4	138.6
May	140.9	135.7	103.8	124.2	144.8
June	141.6	135.7	104.4	123.4	139.1
July	141.7	136.9	103.5	130.9	147.8
Aug	143.6	138.2	103.9	126.6	155.1
Sept	143.6	138.1	104.0	134.6	150.1
Oct	143.6	138.2	104.0	132.4	149.1
Nov	142.7	137.3	103.9	136.1	158.9
Sept-Nov 1986	137.0	134.8	101.7	128.6	142.5
June-Aug 1987	142.3	136.9	103.9	126.9	147.4
Sept-Nov 1987	143.3	137.9	103.9	134.4	152.7
% Change					
Latest 3 months on					
- previous 3 months	+ ½	+ ½	-	+ 6	+ 3½
- same 3 months one year ago	+ 4½	+ 2½	+ 2½	+ 4½	+ 7

e Export unit value index as a percentage of the import unit value index.

VALUE AND VOLUME OF EXPORTS AND IMPORTS EXCLUDING THE MORE ERRATIC ITEMS[f]

Table 5

(Balance of Payments basis)

seasonally adjusted

	Value £ million fob		Volume Index 1980 = 100	
	Exports	Imports	Exports	Imports
1985	73819	76749	123.1	133.7
1986	67459	77657	126.0	142.5
1986 Q3	16367	19561	126.5	147.7
Q4	17759	21146	133.0	153.8
1987 Q1	18125	19833	132.9	141.8
Q2	17968	20709	129.5	149.2
Q3	18881	22494	134.2	161.3
1987 March	5910	6461	129.3	137.2
Apr	6142	6751	135.0	146.2
May	5913	7165	127.3	153.9
June	5913	6793	126.1	147.4
July	6184	7328	132.9	156.9
Aug	6182	7791	131.7	166.3
Sept	6515	7376	137.9	160.8
Oct	6245	7336	134.0	157.3
Nov	6410	7847	139.1	169.9
Sept-Nov 1986	17423	20584	131.3	151.0
June-Aug 1987	18279	21912	130.2	156.9
Sept-Nov 1987	19169	22558	137.0	162.6
% Change				
Latest 3 month on				
- previous 3 months	+ 5	+ 3	+ 5	+ 3½
- same 3 months one year ago	+ 10	+ 9½	+ 4½	+ 7½

f These are defined as ships, North Sea installations, aircraft, precious stones, and silver.

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TRADE IN OIL[9]
(Balance of Payments basis)

seasonally adjusted

	Balance of Trade in oil	Exports of Oil					Imports of Oil				
		Total	Crude Oil [SITC (REV 2) 333.0]			Rest of Division 33	Total	Crude Oil [SITC (REV 2) 333.0]			Rest of Division 33
	£ million fob	£ million fob	£ million fob	million tonnes	Avg value per tonne £ fob	£ million fob	£ million fob	£ million fob	million tonnes	Avg value per tonne £ fob	£ million fob
1985	+ 8104	16134	13006	79.6	163.4	3128	8029	4234	26.9	157.6	3796
1986	+ 4056	8221	6294	82.1	76.7	1927	4165	2324	32.6	71.2	1841
1986 Q3	+ 621	1529	1120	19.7	57.0	408	908	435	8.7	50.1	473
Q4	+ 785	1886	1533	21.6	71.0	353	1101	617	9.6	64.5	404
1987 Q1	+ 1164	2225	1824	21.9	83.4	401	1061	624	7.9	79.3	437
Q2	+ 1033	2076	1658	19.8	83.6	417	1042	658	8.3	79.3	384
Q3	+ 945	2073	1641	18.6	88.1	431	1127	642	7.8	81.9	485
1987 Mar	+ 454	743	624	7.4	84.6	119	289	173	2.1	81.7	116
Apr	+ 423	832	679	8.0	84.9	153	409	269	3.4	79.2	139
May	+ 365	629	516	6.4	81.3	113	264	127	1.6	77.5	137
June	+ 245	615	464	5.5	84.5	151	370	261	3.3	80.2	108
July	+ 287	657	494	5.8	85.2	163	370	218	2.8	78.9	152
Aug	+ 372	758	623	6.8	91.2	135	387	234	2.9	79.7	152
Sept	+ 286	657	524	6.0	87.2	133	371	190	2.1	88.7	181
Oct	+ 386	698	558	6.4	87.4	140	312	174	2.2	80.4	137
Nov	+ 341	714	566	6.8	82.9	148	374	261	3.3	78.8	112
Sep-Nov 1986	+ 780	1795	1434	21.1	68.0	362	1015	489	8.0	61.0	526
Jun-Aug 1987	+ 904	2030	1581	18.1	87.2	449	1126	714	9.0	79.6	413
Sep-Nov 1987	+ 1013	2069	1649	19.2	85.7	421	1057	626	7.6	82.0	431
% Change Latest 3 months on											
- previous 3 months		+ 2	+ 4½	+ 6	- 1½	- 6½	- 6	- 12	- 15	+ 3	+ 4½
- same 3 months one year ago		+ 15	+ 15	- 9	+ 26	+ 16	+ 4	+ 28	- 5	+ 35	- 18

9 Trade in petroleum and petroleum products. These figures differ from those published by the Department of Energy which are on a time of shipment basis (see paragraph 8 of the standard notes).

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TRADE IN GOODS OTHER THAN OIL
(Balance of Payments basis)

	Total								Excluding Erratics[f]			
	Value, £ million, fob (seasonally adjusted)			Unit value index 1980 = 100 (not seasonally adjusted)			Volume index 1980 = 100 (seasonally adjusted)		Value, £ million fob (seasonally adjusted)		Volume index 1980 = 100 (seasonally adjusted)	
	Balance of non oil trade	Exports	Imports	Exports	Imports	Terms of Trade[e]	Exports	Imports	Exports	Imports	Exports	Imports
1985	- 10282	61977	72259	141.8	141.8	100.0	110.6	133.0	57685	68719	114.9	142.8
1986	- 12519	64621	77141	145.1	141.5	102.6	115.2	140.5	59238	73491	117.7	150.9
1986 Q3	- 3512	16024	19536	145.3	140.3	103.5	114.7	143.7	14839	18653	118.5	154.4
Q4	- 3510	17454	20964	148.1	146.3	101.3	123.1	149.4	15873	20045	125.3	161.4
1987 Q1	- 2300	17411	19711	149.7	148.0	101.1	121.8	139.7	15899	18772	124.4	150.4
Q2	- 3415	17312	20728	150.3	143.7	104.6	119.5	149.2	15892	19667	122.5	159.8
Q3	- 3994	18289	22283	151.6	144.8	104.7	125.8	159.8	16808	21367	129.3	172.9
1987 Mar	- 870	5686	6557	150.1	147.6	101.7	118.5	139.1	5168	6172	120.5	148.3
Apr	- 950	5776	6726	150.0	145.3	103.3	120.5	144.3	5310	6343	123.5	153.8
May	- 1472	5757	7229	150.2	143.0	105.0	118.8	156.6	5284	6901	121.9	168.6
June	- 993	5779	6772	150.6	142.7	105.6	119.2	146.6	5298	6423	122.0	157.0
July	- 1212	6105	7317	150.5	144.1	104.4	126.5	156.5	5527	6959	128.4	168.1
Aug	- 1879	5808	7687	151.8	145.1	104.6	119.6	164.4	5424	7404	124.9	178.5
Sept	- 903	6377	7280	152.6	145.2	105.0	131.1	158.6	5858	7004	134.6	172.1
Oct	- 1268	6169	7437	152.8	145.5	105.0	126.6	159.8	5546	7024	127.8	170.7
Nov	- 1536	6236	7772	152.2	144.7	105.2	128.9	168.8	5696	7473	131.7	182.8
Sept-Nov '86	- 3431	17171	20602	147.2	144.4	102.0	121.3	148.3	15628	19569	123.6	158.9
June-Aug '87	- 4084	17692	21776	151.0	144.0	104.9	121.8	155.8	16249	20786	125.1	167.9
Sept-Nov '87	- 3706	18782	22489	152.5	145.1	105.1	128.9	162.4	17100	21502	131.4	175.2
% Change												
Latest 3 months on												
- previous 3 months		+ 6	+ 3½	+ 1	+ 1	-	+ 6	+ 4	+ 5	+ 3½	+ 5	+ 4½
- same 3 months one year ago		+ 9½	+ 9	+ 3½	+ ½	+ 3	+ 6½	+ 9½	+ 9½	+ 10	+ 6½	+ 10

f These are defined as ships, North Sea installations, aircraft, precious stones, and silver.

e Export unit value index as a percentage of the import unit value index.

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Table 8

EXPORTS BY COMMODITY
(Overseas Trade Statistics basis)

£ million, fob, seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
1985	78392	4971	2128	16795	52506	48473	18458	9412	9046	30015	1343	5257	13475	9940
1986	73009	5478	2046	8683	54595	49697	18758	9692	9066	30939	1362	5712	13682	10183
1986 Q3	17632	1394	542	1614	13582	12506	4800	2470	2330	7706	362	1470	3407	2467
Q4	19347	1571	561	1970	14570	13139	4924	2539	2386	8215	361	1534	3579	2740
1987 Q1	19637	1372	624	2309	14642	13287	4880	2507	2374	8407	459	1660	3542	2745
Q2	19316	1347	543	2158	14614	13260	4880	2498	2381	8380	488	1653	3517	2722
Q3	20431	1456	543	2177	15640	14277	5377	2757	2620	8900	533	1835	3613	2918
1987 Sept	7048	492	178	693	5485	5011	1858	969	889	3153	183	679	1254	1038
Oct	7058	514	156	729	5407	4812	1761	899	863	3051	197	558	1295	1000
Nov	7008	460	175	737	5367	4839	1787	929	857	3052	172	626	1224	1030
June-Aug	19735	1407	553	2121	15027	13685	5174	2616	2558	8511	501	1684	3536	2789
Sept-Nov	21114	1466	509	2158	16258	14662	5406	2797	2609	9256	551	1863	3774	3068
Percentage change	+ 7	+ 4	- 8	+ 2	+ 8	+ 7	+ 4½	+ 7	+ 2	+ 9	+ 10	+ 11	+ 6½	+ 10

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

Table 9

EXPORTS BY COMMODITY: VOLUME INDICES
(Overseas Trade Statistics basis)

INDICES 1980 = 100, seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	69	31	136	735	658	252	112	141	406	18	71	170	147
1985	119.3	119.2	106.1	171.7	110.8	115.7	118.9	133.3	107.5	113.6	99.4	111.6	121.2	107.6
1986	123.6	129.6	117.1	175.5	114.0	116.9	121.9	139.4	108.1	113.8	93.2	117.5	120.4	106.9
1986 Q3	124.4	134	126	174	113	118	125	143	111	113	97	122	120	102
Q4	130.5	146	129	179	120	123	127	146	112	120	91	123	126	115
1987 Q1	130.2	129	145	183	119	122	126	143	112	120	114	133	120	114
Q2	125.7	124	120	171	118	121	125	140	113	118	120	133	118	112
Q3	132.2	133	124	164	126	130	136	153	123	126	127	144	122	123
1987 Sept	135.9	136	123	158	132	136	140	161	124	134	129	159	127	131
Oct	136.1	144	109	170	130	131	135	152	120	129	138	130	132	124
Nov	136.9	126	123	180	130	133	137	157	120	130	123	146	125	131
June-Aug	127.9	128	125	161	121	125	132	145	121	121	121	132	119	117
Sept-Nov	136.3	135	119	170	130	133	137	157	122	131	130	145	128	128
Percentage change	+ 6½	+ 5½	- 5	+ 5	+ 7½	+ 6½	+ 4	+ 8	+ ½	+ 8½	+ 7½	+ 9½	+ 7½	+ 10

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

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until [illegible] of press notice on [illegible] at 11.[illegible]

Table 10

EXPORTS BY COMMODITY: UNIT VALUE INDICES
(Overseas Trade Statistics basis)

INDICES 1980 = 100 not seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]								
						Total	Semi-manufactures excluding precious stones & silver(PS)			Finished manufactures excluding ships, North Sea installations and aircraft (SNA)				
							Total	Chemicals	Other	Total	Passenger Motor Cars	Other Consumer	Intermediate	Capita
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	69	31	136	735	658	252	112	141	406	18	71	170	147
1985	143.4	134	140	155	143	142	135	139	132	147	162	147	150	141
1986	136.5	140	123	81	147	148	138	141	135	154	182	157	157	146
1986 Q3	134.2	140	120	62	148	148	137	140	135	155	186	156	159	146
Q4	138.0	142	121	72	151	150	139	141	138	157	198	161	160	148
1987 Q1	140.5	141	122	82	152	153	141	144	139	160	201	164	163	150
Q2	141.0	140	123	81	153	154	141	145	137	162	204	163	168	150
Q3	142.8	141	125	86	155	155	143	146	140	163	210	166	167	151
1987 Sept	143.4	141	124	84	156	157	144	148	141	164	214	168	168	152
Oct	143.5	141	123	83	156	157	144	147	142	165	214	167	168	153
Nov	142.6	140	126	80	155	156	143	146	141	165	212	168	169	152
June-Aug	142.1	140	124	85	154	155	142	146	138	163	206	165	168	150
Sept-Nov	143.2	141	124	83	156	157	144	147	141	164	213	167	169	152
Percentage change	+ ½	+ ½	-	- 2½	+ 1	+ 1	+ 1½	+ 1	+ 2	+ 1	+ 3½	+ 2	+ ½	+ 1½

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

Table 11

EXPORTS BY AREA
(Overseas Trade Statistics basis)

£ million, fob, seasonally adjusted

	Total K	Developed Countries						Developing Countries			Centrally planned economies
		Total	European Community	Rest of W Europe	North America Total	USA	Other	Total	Oil exporting countries	Other	
1985	78392	62787	38226	7438	13332	19	3791	13876	5952	7924	1587
1986	73009	57709	35004	6963	12128	10380	3614	13139	5495	7644	1721
1986 Q3	17632	13944	8498	1709	2829	2432	909	3215	1317	1897	368
Q4	19347	15474	9545	1799	3225	2717	905	3254	1238	2016	470
1987 Q1	19637	15715	9330	1747	3676	3153	962	3401	1313	2088	437
Q2	19316	15515	9789	1903	2886	2407	937	3445	1306	2139	337
Q3	20431	16404	10093	1965	3264	2768	1083	3580	1346	2233	415
1987 Sept	7048	5652	3548	703	1025	885	375	1160	436	724	142
Oct	7058	5679	3503	678	1129	983	369	1224	519	705	130
Nov	7008	5754	3517	718	1097	942	423	1142	449	693	121
June-Aug	19735	15831	9754	1874	3187	2682	1016	3543	1326	2217	364
Sept-Nov	21114	17085	10568	2099	3251	2810	1166	3526	1403	2122	393
Percentage change	+ 7	+ 8	+ 8½	+ 12	+ 2	+ 5	+ 15	- ½	+ 6	- 4½	+ 8

K See paragraph 6 of Notes to Editors.

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Table 12

IMPORTS BY COMMODITY
(Overseas Trade Statistics basis)

£ million cif seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
1985	85027	9337	5388	10664	58312	54934	19611	6901	12710	35322	4165	8884	11623	10649
1986	86066	10067	4988	6294	62833	59472	20713	7346	13367	38759	4809	10177	12706	11067
1986 Q3	21836	2564	1190	1502	16041	15199	5207	1831	3376	9992	1279	2653	3268	2792
Q4	23269	2632	1376	1541	17146	16303	5472	1922	3549	10832	1279	2838	3597	3118
1987 Q1	21819	2473	1386	1468	16148	15248	5377	1943	3434	9871	1054	2576	3289	2952
Q2	22819	2450	1411	1465	17176	16183	5686	2024	3662	10497	1196	2785	3549	2967
Q3	25009	2586	1423	1649	18598	17777	6100	2159	3941	11678	1447	2999	3925	3308
1987 Sept	8098	870	483	551	6057	5797	2022	694	1328	3775	410	999	1254	1112
Oct	8321	836	476	497	6391	6005	2078	729	1349	3927	454	1029	1321	1124
Nov	8533	865	476	510	6563	6305	2119	728	1391	4186	498	1116	1412	1161
June-Aug	24421	2498	1401	1618	18199	17297	5933	2134	3779	11364	1453	2963	3802	3146
Sept-Nov	24952	2572	1434	1559	19011	18107	6219	2151	4068	11888	1362	3144	3986	3396
Percentage change	+ 2	+ 3	+ 2½	- 3½	+ 4½	+ 4½	+ 5	+ 1	+ 7	+ 4½	- 6½	+ 6	+ 5	+ 8

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

Table 13

IMPORTS BY COMMODITY: VOLUME INDICES
(Overseas Trade Statistics basis)

INDICES 1980 = 100 seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished: Passenger Motor Cars	Finished: Other Consumer	Finished: Intermediate	Finished: Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	124	81	138	626	543	217	63	154	326	42	94	96	94
1985	124.6	114.4	102.2	86.2	140.7	154.4	143.9	176.1	130.6	161.4	127.9	139.5	172.8	187.1
1986	132.8	123.5	108.7	93.4	148.2	163.0	152.0	188.0	137.2	170.4	131.6	158.3	187.0	183.1
1986 Q3	138.1	126	106	112	153	168	155	191	140	176	142	165	193	185
Q4	142.4	125	119	106	158	174	157	192	142	186	133	170	205	205
1987 Q1	130.9	120	122	91	146	161	152	191	136	166	103	156	185	187
Q2	137.8	120	122	90	158	173	163	205	146	179	121	172	203	192
Q3	151.7	126	121	104	171	190	174	217	157	200	147	184	224	215
1987 Sept	149.0	128	127	107	169	188	173	206	159	198	125	185	217	219
Oct	149.8	122	121	92	176	193	175	215	158	205	134	189	230	221
Nov	155.6	128	118	96	183	204	179	215	164	220	147	210	248	229
June-Aug	147.4	121	119	101	167	184	170	215	152	194	148	182	217	203
Sept-Nov	151.5	126	122	98	176	195	175	212	160	207	136	195	232	223
Percentage change	+ 3	+ 4	+ 2½	- 2½	+ 5½	+ 5½	+ 3	- 1½	+ 6	+ 7	- 8	+ 7	+ 7	+ 9½

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

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IMPORTS BY COMMODITY: UNIT VALUE INDICES
(Overseas Trade Statistics basis)

INDICES 1980 = 100 not seasonally adjusted

	Total	Food beverages and tobacco	Basic Materials	Fuels	Total Manufactures	Manufactures excluding erratics[h]: Total	Semi-manufactures excluding precious stones & silver (PS): Total	Semi-manufactures: Chemicals	Semi-manufactures: Other	Finished manufactures excluding ships, North Sea installations and aircraft (SNA): Total	Finished (SNA): Passenger Motor Cars	Finished (SNA): Other Consumer	Finished (SNA): Intermediate	Finished (SNA): Capital
SITC (REV 2)	0-9	0+1	2+4	3	5-8	5-8 less SNAPS	5+6 less PS	5	6 less PS	7+8 less SNA	j	j	j	j
Weights	1000	124	81	138	626	543	217	63	154	326	42	94	96	94
1985	143.1	137	130	172	141	141	133	139	130	146	152	147	155	134
1986	132.5	136	113	97	143	144	133	141	130	152	170	148	158	141
1986 Q3	129.1	136	111	78	142	144	132	139	130	152	168	147	159	141
Q4	135.1	139	115	84	149	150	137	145	133	159	178	155	167	147
1987 Q1	137.9	138	117	94	151	152	138	147	135	162	189	155	167	151
Q2	134.8	136	117	93	147	149	137	145	133	157	183	149	164	148
Q3	136.0	135	117	95	148	150	139	149	134	158	184	152	163	147
1987 Sept	136.1	135	117	95	149	150	139	151	135	158	183	153	162	147
Oct	136.4	135	116	95	149	151	141	151	137	158	184	155	161	147
Nov	135.6	134	117	94	149	151	140	150	136	158	187	152	161	147
June-Aug	135.3	135	117	94	147	149	138	147	134	157	183	150	164	146
Sept-Nov	136.0	134	117	94	149	151	140	150	136	158	185	153	161	147
Percentage change	+ ½	- ½	- ½	- ½	+ 1	+ 1	+ 2	+ 2½	+ 1½	+ ½	+ 1	+ 2½	- 1½	+ ½

h These are defined as ships, North Sea installations (together comprising SITC (REV 2) 793), aircraft (792) precious stones (667), and silver (681.1).

j Based on the United Nations Broad Economic Categories end-use classification.

IMPORTS BY AREA
(Overseas Trade Statistics basis)

£ million cif seasonally adjusted

	Total K	Developed Countries: Total	Developed: European Community	Developed: Rest of W Europe	Developed: North America Total	Developed: North America USA	Developed: Other	Developing Countries: Total	Developing: Oil exporting countries	Developing: Other	Centrally planned economies
1985	85027	71665	41474	12102	11709	9926	6379	11327	2815	8512	1893
1986	86066	73285	44506	11864	10054	8468	6861	10514	1877	8637	1856
1986 Q3	21836	18569	11426	2896	2512	2138	1735	2670	408	2262	456
Q4	23269	19705	11950	3151	2771	2331	1833	2928	511	2418	511
1987 Q1	21819	18642	11411	3076	2435	2025	1720	2520	442	2078	482
Q2	22819	19659	12100	3259	2616	2223	1684	2632	380	2251	497
Q3	25009	21152	12980	3367	2873	2446	1932	3200	466	2734	562
1987 Sept	8098	6744	4168	987	954	824	636	1078	202	876	197
Oct	8321	7144	4328	1177	968	823	671	976	141	835	173
Nov	8533	7499	4561	1246	1000	855	692	927	121	805	203
June-Aug	24421	20882	12735	3462	2772	2338	1914	3019	383	2636	524
Sept-Nov	24952	21387	13058	3410	2922	2502	1999	2981	464	2517	573
Percentage change	+ 2	+ 2½	+ 2½	- 1½	+ 5½	+ 7	+ 4½	- 1	+ 21	- 4½	+ 9½

K See paragraph 6 Notes to Editors.

SECRET and personal until release of press notice on 23 DEC 87 at 11.30 a.m.

COMMODITY ANALYSIS OF VISIBLE TRADE
(Balance of Payments basis)

£ million, seasonally adjusted

SITC (R2)	Food Beverages and Tobacco 0 + 1			Basic Materials 2 + 4			Fuels 3		
	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance
1985	4932	8522	- 3591	2144	4795	- 2651	16795	10233	+ 6562
1986	5439	9230	- 3792	2058	4416	- 2359	8683	5994	+ 2690
1985 Q4	1194	2083	- 889	504	1070	- 566	3862	2237	+ 1625
1986 Q1	1219	2247	- 1027	504	1092	- 588	3177	1641	+ 1536
Q2	1271	2213	- 942	445	1076	- 631	1922	1426	+ 496
Q3	1383	2356	- 973	545	1025	- 480	1614	1393	+ 221
Q4	1565	2415	- 849	564	1223	- 659	1970	1533	+ 438
1987 Q1	1354	2285	- 931	629	1232	- 603	2308	1413	+ 895
Q2	1345	2273	- 928	553	1177	- 624	2146	1414	+ 732
Q3	1439	2374	- 935	545	1216	- 671	2153	1595	+ 559

SITC (R2)	Semi-Manufactures 5 + 6			Finished Manufactures 7 + 8			Total Manufactures 5 - 8		
	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance	Exports fob	Imports fob	Visible Balance
1985	20051	19949	+ 102	32221	35324	- 3103	52271	55273	- 3002
1986	20946	21524	- 578	33540	38453	- 4913	54486	59977	- 5491
1985 Q4	4952	4900	+ 53	8096	8645	- 549	13048	13545	- 497
1986 Q1	4851	5294	- 443	7925	8751	- 825	12777	14045	- 1269
Q2	5221	5179	+ 42	8395	9092	- 697	13615	14271	- 656
Q3	5290	5339	- 49	8230	9922	- 1692	13520	15261	- 1741
Q4	5585	5712	- 127	8990	10688	- 1698	14575	16400	- 1826
1987 Q1	5474	5652	- 178	9190	9748	- 558	14664	15400	- 736
Q2	5522	5844	- 322	9170	10724	- 1555	14692	16568	- 1876
Q3	5818	6220	- 402	9797	11561	- 1763	15616	17781	- 2165

Monthly data at this level of detail are published in the Monthly Review of External Trade Statistics.

and personal
press notice on 23 DEC 87 at 11.30 a.m.

CONFIDENTIAL

FROM: J M HALLIGAN

DATE: 20 January 1988

AC 20/1

1. ~~MRS CASE~~
2. CHIEF SECRETARY

cc Chancellor
Financial Secretary
Economic Secretary
Sir P Middleton
Sir G Littler
Sir A Wilson
Mr Beastall
Mrs Lomax
Mr Mountfield
Mr H Evans
Mr Inglis
Mr Bush

Given that ECGD is a Govt dept! the C&AG's posn is palpably absurd, & I trust we make this crystal clear in press briefing

ECGD TRADING RESULTS 1986-87

These will be laid before the House on Tuesday 26 January. The main feature, which will attract considerable media attention, will be the C and AG's qualification of the accounts because he cannot take a view on whether the level of ECGD's general provision is adequate given the uncertainties on sovereign debt (copy below). Publication of the accounts has been much delayed by an acrimonious dispute over this qualification.

2. The main features of ECGD's accounts are as follows:

   i. A trading surplus of £178 million in 1986-87 compared with £239 million in 1985-86.

   ii. An increase in the general provision of £539 million to a total figure of £1120 million to reflect the deteriorating prospects for repayment of sovereign debt. This has the effect of reducing ECGD's reserves to £201 million from £563 million in 1985-86.

   iii. Claims of £803 million were paid, mainly against political risks. Recoveries were £340 million making a net claim position of £463 million.

3. The main focus of attention is likely to be the £1.1 billion general provision. ECGD have increased it to a point where it now equals 17.7 per cent of sovereign debt, to take account of

the worsening prospects of repayment. The C and AG's argument is that if the Bank of England matrix was applied to ECGD's sovereign debt book the general provision would be between £1.4 and £2.1 billion. This would be equivalent to 22-33 per cent of their debt and compares with provisions made by commercial banks of 25-30 per cent. The C and AG points out that provisioning at these levels would wipe out ECGD's total reserves. The implication is that ECGD have not made a "realistic" provision because they want to avoid showing negative net assets. (ECGD cannot go bankrupt of course because they have unlimited access to the Consolidated Fund. Their borrowings at 31 March 1987 from the Consolidated Fund were £1 billion).

4. The C and AG also criticises ECGD's practice of charging the increase in the general provision that they have made against reserves rather than the income and expenditure account. This is a more technical point and ECGD is changing the form of its account next year in a way that would accommodate the NAO's preferred treatment in future.

5. ECGD have had a lengthy dispute with the NAO about the qualification but were not able to persuade NAO to withdraw. ECGD argue:

i. They have used the same method for calculating the general provision for the last two years and NAO have never hitherto queried it.

ii. The Bank of England matrix is designed for commercial banks supervision and must take account not only of ultimate recoverability of debts but also the solvency of a bank whose assets are impaired because of delays in repayment of debts. ECGD is a Government Department whose solvency is not in doubt and they need only provision against non-recoverability. ECGD also claim (rather more doubtfully in our opinion) that they have better prospects of ultimate repayment than the commercial banks.

6. In formulating these arguments ECGD consulted both the Bank of England supervisors and the Treasury (including Sir A Wilson).

However, the "adequacy" argument is one which is impossible to resolve objectively because it depends upon views about the future prospects on sovereign debt. The prospects have darkened over the last 12 months and ECGD have responded by doubling their provision. NAO say they have not gone far enough. There is force in ECGD's argument that they are different from banks in only having to provision against ultimate non-recovery and not difficulties in securing repayment on the way. But we could not pretend that ECGD's view about the extent of ultimate recoverability is the only sensible view on the subject.

7. The usual practice is not to comment immediately on NAO reports and to reserve comment until the PAC hearing. However, on this occassion, ECGD will be giving factual briefings to ensure that the media understand their point of view. The PAC hearing is scheduled for 16 March and will be difficult. We shall clear the line we take at that meeting with Ministers in due course. By then we shall have a clearer idea of the approach which is being adopted by commercial bank auditors.

J.M. Halligan.

J M HALLIGAN

I certify that I have examined the financial statements on pages 7 to 24 in accordance with Section 5(3) of the Exchequer and Audit Departments Act 1921 and the National Audit Office auditing standards.

Because of the accounting treatment of the general provision, described in paragraphs 13 to 15 of my report, in my opinion the financial statements do not give a true and fair view of the state of affairs of the Export Credits Guarantee Department's trading activities at 31 March 1987 for the guarantees to which these statements relate or of the results or source and application of funds for the year then ended. The treatment has resulted in the overstatement of the trading surpluses of individual account years up to and including 1986/87. Correction of the treatment would have transformed the £179.1 million estimated trading surplus for 1986-87 on the combined accounts to a deficit of £64.3 million. In addition because of the uncertainty about the adequacy of the general provision, to which I draw attention in paragraphs 6 to 11 of my Report, and the fundamental importance of its size in relation to the results disclosed I am in any event unable to form an opinion as to whether the financial statements give a true and fair view of these trading activities. In other respects, the financial statements have, in my opinion, been properly prepared in the form approved by the Treasury in accordance with Section 5(1) of the Exchequer and Audit Departments Act 1921.

JOHN BOURN
Comptroller and Auditor General
15 January 1988

REPORT OF THE COMPTROLLER AND AUDITOR GENERAL

CERTIFICATION OF TRADING RESULTS

1. The purpose of the Trading Accounts of the Export Credit Guarantee Department (ECGD) is to show a true and fair view of the trading outturns for the most recent financial year and for those earlier years which remain open until provisions for losses can be assessed with sufficient confidence to allow the trading balances for the years to be transferred to the cumulative reserves.

2. In forming my audit opinion on these Accounts, I have, as in previous years, recognised the estimated nature of the Trading results stated for the open years. But, as indicated in my certificates and for the reasons explained in paragraphs 6 to 11, 13 to 16 and 25, I have been unable to give unqualified opinions on the 1986-87 Accounts.

FORM OF ACCOUNT

3. A review of the Department's accounting policies has led to a recommendation for a new format for the 1987-88 Accounts. The present open year accounting format will be discontinued and one annual account only would be produced in order that the effect of all events in the financial year on ECGD's overall financial position can be more readily understood by the reader of the accounts. I welcome this.

COMMERCIAL AND NATIONAL INTEREST OPERATIONS

Restatement of opening balances

4. The 1986-87 Accounts cover the trading period of 1 April 1986 to 31 March 1987 and have been adjusted to take account of all material relevant events relating to that period up to ECGD's signing of the Accounts during August 1987. Furthermore, prior year figures on Statement 3 have been restated following a decision by the Treasury to move the Tender To Contract (TTC) facility from the Trading Accounts to the Public Expenditure Programme. The cumulative losses accrued on this facility have been removed from these accounts. The effect has been to increase ECGD's opening balance on Open Year Surpluses and

Cumulative Reserves by £107 million and to remove £104 million owing to the Consolidated Fund.

1986-87 Results

5. The accounts for 1986-87 show a combined net estimated trading surplus on the Commercial and National Interest Accounts of £179 million for business during the year and a small net reduction of £1 million in the surpluses previously declared for earlier years. Taken together, a trading surplus of £178 million has been recognised in the period. However, as explained at paragraphs 6 to 15, the general provision against loss on sovereign debt, including accrued interest, has been increased by £540 million and, in accordance with ECGD's accounting policies, the increase has been charged against the Cumulative Reserves. Thus the trading developments recognised in 1986-87 have resulted in a decrease in reserves and open year surpluses of £362 million so that ECGD's net assets have reduced from £563 million to £201 million and the adverse balance on cumulative reserves on the combined accounts has increased from £386 million to £858 million.

The adequacy of the general provision

6. In March 1987, the Accounting Officer told the Public Accounts Committee that he did not expect the general provision to increase much further on the then known assumptions. The Department originally calculated a general provision which reflected this expectation based on risk rating individual countries and applying percentage provisions depending on the levels of risk rating. However, during early 1987 and continuing throughout the Summer, there was a series of international developments and initiatives on possible ways of dealing with debtor nation indebtedness. These included proposals by Brazil, Mexico, Nigeria and Poland (all of whom are heavily in debt to ECGD) for re-scheduling their debts over lengthy periods and reducing or suspending interest payments. And, in the Spring of 1987, the interim results of some leading commercial banks included substantial additional international debt provisions. ECGD consulted with the Treasury and the Bank of England on the implications of the banks' increased provisions for ECGD's Accounts. In the light of these developments, ECGD recalculated their general provision by increasing substantially the percentages they applied to the debt principal for the various levels of risk ratings and by a much

higher level of increase in the provision made in respect of unpaid interest. This resulted in the £1,122 million general provision included in the accounts which represents 17.7 per cent of sovereign debt.

7. In August 1987, the Bank of England considered that there had been a serious recent deterioration in the position of the troubled debtor countries and issued a letter to UK banks proposing guidelines for a more objective method for determining consistent provisions for supervisory purposes. This suggested a range of provisions which was much higher than ECGD's revised percentages; and a general provision for ECGD based on this advice would have totalled between £1.4 and 2.1 billion, as against their actual provision of £1.1 billion. It is not clear to what extent the banks' provisions will reflect the Bank of England proposals (much will clearly depend on the mix of countries in debt to them) but provisions in their interim accounts for 1987 ranged from 25 to 30 per cent - as against ECGD's general provision of 17.7 per cent.

8. ECGD consider that it would be inappropriate for them to follow the Bank of England's guidelines since their situation is different fundamentally from the banks'. They point out

that banks, being commercial, are subjected to tests by supervisory bodies as to their solvency, reserves adequacy and general financial health. In ECGD's view, to satisfy such tests, the banks' provisions must take into account not only the risk that debt will not be recovered but also the effect of delays in recovery and other prudential and commercial considerations. They considered, by contrast, the solvency of ECGD, being a government department, is not in doubt and, therefore, timing aspects need not (and never have) featured in their calculation of the general provision. ECGD point out, too, that in addition to their general provision, they make significant additional specific provisions in respect of other overseas government and public sector debt not included in their sovereign debt figure.

9. Moreover, in ECGD's view, the method recommended by the Bank of England for banks does not reflect other considerations that apply to the Department. These include the different nature of their debt which, inter alia, includes potential as well as actual claims paid; debtor nations' favourable attitude to them, secured through the "Paris Club", comprising central government representatives, which negotiates with debtor nations on the export credit agencies' behalf; and their ability to take a longer-term view of

recoverability which gives them better prospects for recovering debt. In setting the level of their general provision they had ensured, too, that it was sufficient to cover a large default on interest or principal by any one of their major debtor countries (Poland, Nigeria, Mexico and Brazil).

10. ECGD state in paragraph 14 of the foreword to the accounts that the general provision does not purport to give the Department's view of the loss likely to be suffered on sovereign debt and that the Department had no basis on which to make such a judgement. It seemed to me however that, notwithstanding the differences between ECGD and the banks referred to in paragraphs 8 and 9 above, the Bank of England guidelines could provide an independent and objective benchmark for assessing the reasonableness of ECGD's provision against loss on their sovereign debts. I therefore sought from the Department details of the differences in treatment being accorded by debtor nations to ECGD on the one hand and to the banks on the other, especially by the ECGD's four major debtor countries (referred to in paragraph 6) who account for 62 per cent of their sovereign debt. They were able to point to significant differences in treatment, many of which - but not all - put them in a more favourable position than the banks. In

my view, however, some of these differences could be recognised in applying the Bank of England guidelines to the ECGD situation. And it was not clear that the remaining differences were such as to justify fully the substantial divergence between the levels of provisions set by ECGD and the much higher levels - in some instances more than double - that would be required in respect of these nations' debts if the Bank of England guidelines had been applied.

11. In view of the disparity between the level of ECGD's general provision and the size of the provision that would be calculated under the Bank of England guidelines (see paragraph 7); the difficulty of quantifying the effects of the differences between ECGD's situation and that of the banks and given also the volatility that presently exists in relation to international debt I am unable to express an opinion on the adequacy of ECGD's general provision as at 31 March 1987. I observe, though, that ECGD's accumulated trading surpluses and reserves were insufficient to bear an increase in the general provision of the size implied by the Bank of England's advice unless the balance sheet was to show a negative asset position. In relation to the possible implications of this for the ECGD's solvency, it should

be noted that the Consolidated Fund stands behind the Department and that this ensures that they remain a going concern.

12. ECGD do not agree with my view for the reasons given in paragraphs 8 to 10. They consider the level of their general provision to be adequate.

The accounting treatment of debt interest and of the general provision

13. As noted in paragraph 5 above the increase in the general provision has been charged to cumulative reserves rather than the annual trading results. This is because ECGD regard the general provision as an earmarked reserve, set aside as a contingency against the risk that not all sovereign debt would be fully recovered. In the light of the continuing and deepening international debt crisis and the current level of ECGD's reserves, I consider that this approach is no longer tenable and that the Department's trading results should reflect the need to provide for reductions in the value of sovereign debt. While the accounts mitigate the presentational effect of this treatment by summarising trading results and movements on reserves in a separate statement (Statement 4), the treatment is out of

line with generally accepted practice and it leads to a failure to match income with its associated provision in the insurance accounts for individual years.

14. ECGD are unable to apportion the general provision between different account years. For this reason I cannot quantify the effect of the accounting treatment on the results shown for individual years but overall, in my opinion, the past years' trading results, including some in years now closed, have been overstated to the extent of the £1,122 million provision. Apart from the case of the additional provision against non-receipt of interest income amounting to £243 million, as noted in paragraph 15 below, the provision all relates to business and income of years prior to 1986-87.

15. Interest income arises almost entirely from interest payable under International Debt Rescheduling (IDR) Agreements in respect of which £234 million was included as income in the year (58 per cent of total income) in arriving at the surplus of £179 million. ECGD account for this by accruing the interest "earned" from the dates of the underlying debts up to 31 March in the year the agreement is signed, and thereafter on an annual basis, and make provision for the

possibility of non-receipt in their calculation of the general provision. Thus, while the £234 million "earned" was taken into account in arriving at the combined estimated surplus for the current year, the additional £243 million provision made for the possibility of non-receipt of earned interest still unpaid was not. In my view, if the normal accounting convention had been followed, the surplus of £179 million shown for 1986-87 for the combined accounts, would instead be a deficit of £64 million.

16. For the reasons given in paragraphs 13-15, in my opinion the financial statements do not give a true and fair view and I have qualified my certificate accordingly.

17. ECGD do not agree with my decision to qualify. They point out that their accounts do not follow a conventional format as they combine a number of accounting principles. They argue that this form of accounts prevents them from taking any other course; that their accounting treatment is consistent with that which they have adopted in previous years without qualification; and that the inadequacies of the present form of account will be remedied by the proposed new format for the 1987-88 accounts. ECGD also consider that applying the normal convention for the interest

provisions, as described in paragraph 15, distorts the result for the year as part of the interest provided for was brought to account in previous years.

Other account features

18. New business underwritten has again fallen from the levels of the previous year. The volume of exports covered, at £14 billion, represents 19.6 per cent of UK visible non-oil exports compared with £16 billion (23.3 per cent) in 1985-86 and £17 billion (25.3 per cent) in 1984/85. Consequently, premium income brought to account has fallen by £17 million. This reflects the more selective underwriting ECGD now apply in the light of the international debt situation and the reduction in extended term business.

19. When negotiating IDR agreements ECGD seek a rate of interest comparable with that charged on the notional balance owing to the Consolidated Fund. The restated balance on the latter rose to £1,001 million at 31 March 1987 (31 March: £652 million) principally because of the continued high level of claims paid compared with recoveries. As a result of the increase in the amounts owing to the Fund, notional interest charges rose from £55 million in 1985-86 to £83 million in 1986-87 thus

adding to Department's indebtedness to the Fund. ECGD expect the balance owing to the Consolidated Fund to remain at around £1000 million providing certain refinancing agreements are implemented.

20. Claims paid in the year totalled £803 million of which £639 million was in respect of political events (1985-86 £777 million and £585 million respectively) and recoveries totalled £341 million (1985-86 £271 million). Recoveries included £94 million from the refinancing of sovereign debt (1985-86 nil). Repayment of the refinancing loans (totalling £289 million at 31 March 1987) and interest is guaranteed by ECGD and the loans are therefore noted as a contingent liability and included in the calculation of the general provision.

21. A substantial amount of the Department's business is conducted in foreign currency which is translated into sterling values for account purposes. Claims recoverable are valued initially at the exchange rates in force at the date the claim is paid and the resulting asset is only revalued for accounts purposes if application of end of year exchange rates results in lower values. For a number of years there has been an unrealised gain on these assets but these were not brought to account. The strength of sterling

against the US Dollar in the last two years has diminished the previous unrealised gains which fell from £95 million to £11 million in 1985-86 and then to an unrealised loss of £38 million in 1986/87. Taken together with a realised loss of £5 million this has given rise to the charge in respect of foreign exchange losses of £43 million in 1986-87.

OVERSEAS INVESTMENT INSURANCE SCHEME

1986-87 results

22. The accounts of the Overseas Investment Insurance (OII) Scheme for 1986-87 record a net estimated trading surplus of £1.2 million for business underwritten during the year, but after increases in specific provisions for earlier years of £1.0 million the surplus recognised in 1986-87 was £0.2 million. The increase in earlier years' provisions reflect the 1986-87 claims experience and follow notification of loss, in accordance with the accounting policies. In addition, ECGD have increased the general provision by £420,000 to £462,000 (1986: £42,000). Thus overall the combined scheme reserves and open year trading surpluses of the scheme have reduced over the year by £0.2 million from £4.1 million to £3.9 million.

The adequacy of the OII general provision

23. In arriving at the general provision ECGD did not apply the same risk ratings to individual countries that they used in deriving the provision for their Commercial and National Interest Accounts. Instead they applied a single percentage (17 per cent) to the total sovereign debt. If they had used the same risk ratings, the provision would have been some £112,000 in total resulting in a charge in the year of £70,000 - as against the amounts actually adopted of £462,000 for the total provision and £420,000 for the charge in the year. A provision based on the Bank of England guidelines would have fallen within the range £290,000 and £480,000 and the charge in the year between £250,000 and £440,000. Since it is therefore possible to support the adequacy of the OII general provision against an independent and objective yardstick, I have not qualified my certificate on this account in the same way as on the main ECGD account.

24. ECGD have stated that they did not apply the same levels of provisions as for the other accounts because OII business is not normally subject to Paris Club arrangements. They

recognised that use of the Bank of England guidelines would suggest a maximum figure of £480,000 but considered this too high. I note, however, that while the provision level used (£462,000) was very near the guidelines maximum, most of the other arguments ECGD advanced for not applying provisions at guidelines levels on the main account (see paragraphs 8 and 9) would also apply to the OII account.

The accounting treatment of the general provision

25. The accounting treatment of the general provision as an adjustment against cumulative reserves is the same as in the Commercial and National Interest Accounts (paragraphs 13 and 14). Therefore it also does not follow generally accepted practice and, in my opinion, leads to a failure to match income with the associated provisions in some of the individual insurance years and to an overstatement of surpluses for these years amounting in total to £462,000. I regard this mis-statement as material rather than one that fundamentally affects the whole account, since the overall effect of trading results and movements on reserves is shown in statement 2; and since the treatment does not lead to the failure

to match interest income with its associated provision in the current year (unlike the position on the Commercial and National Interest Accounts).

JOHN BOURN
Comptroller and Auditor General

National Audit Office
15 January 1988

1

Mr Culpin

A strange estimate. I suspect a confusion with less than was forecast at the Budget time (ie <-7½ bn). However, I may still deliver it by getting the CSO to revise up the 1986 deficit.

Chancellor

I trust you'll now deliver X

cc Sir P Middleton
Sir T Burns
Sir G Littler
Miss O'Mara

RC 24/7

THATCHER SEES 1987 U.K. TRADE DEFICIT NARROWING NRDE

LONDON, JULY 24 - PRIME MINISTER MARGARET THATCHER SAID SHE EXPECTED THE U.K.'S BALANCE OF PAYMENTS DEFICIT THIS YEAR TO BE SLIGHTLY BELOW THE SHORTFALL SEEN LAST YEAR.

SPEAKING ON BBC TELEVISION NEWS, SHE NOTED IN ANSWER TO A QUESTION THE CUMULATIVE CURRENT ACCOUNT BALANCE FOR THE FIRST FIVE MONTHS WAS STILL IN SURPLUS, BUT FORECAST A DETERIORATION LATER THIS YEAR ALTHOUGH GAVE NO SPECIFIC FORECAST.

EARLIER THIS WEEK, OFFICIAL STATISTICS SHOWED THE MONTHLY CURRENT ACCOUNT IN MAY SLUMPED INTO DEFICIT FOR THE FIRST TIME THIS YEAR, WITH A PROVISIONALLY ESTIMATED 561 MLN STG SHORTFALL, COMPARED WITH A 96 MLN SURPLUS IN APRIL.

24-JLY-1232 MON627 MONC

CONTINUED ON - NRDF

P

QUOTES - SEE AAQA 1731

THATCHER SEES =2 LONDON NRDF

LATEST FIGURES FROM THE DEPARTMENT OF TRADE AND INDUSTRY SHOW THE 1986 CURRENT ACCOUNT WAS IN DEFICIT BY 120 MLN STG, WITH INVISIBLE EARNINGS OF 8.13 BILLION OFFSET BY A SHORTFALL OF 8.25 BILLION IN VISIBLE TRADE.

THE TREASURY SAID IT WILL NOT OFFICIALLY REVISE THE MARCH BUDGET FORECAST OF AN OVERALL CURRENT ACCOUNT DEFICIT OF 2.5 BILLION STG THIS CALENDAR YEAR UNTIL THE CHANCELLOR OF THE EXCHEQUER'S AUTUMN STATEMENT ON THE ECONOMY.

24-JLY-1241 MON637 MONC

CONTINUED FROM - NRDE

P

CONTINUED ON - NREH

QUOTES - SEE AAQA 1731

NREH

THATCHER SEES =3 LONDON

"IF YOU TAKE THE TRADE FIGURES FROM THE BEGINNING OF THE YEAR TO NOW, WE'RE ACTUALLY IN SURPLUS NOW. WE HAD FOUR VERY, VERY GOOD MONTHS AND THEN WE'VE HAD ONE BAD MONTH. OBVIOUSLY WE'RE GOING TO WATCH IT CAREFULLY," THATCHER SAID.

X "WE EXPECT A SLIGHT DEFICIT THIS YEAR, BUT NOT A SERIOUS DEFICIT, RATHER LESS THAN LAST YEAR," SHE ADDED.

THATCHER REJECTED GROWING SPECULATION THAT THE U.K. ECONOMY WAS OVERHEATING.

ASKED IN THE INTERVIEW WHETHER SHE WAS CONCERNED ABOUT POSSIBLE OVERHEATING, SHE REPLIED "NO," BUT ADDED THAT "WE'RE WATCHING OUT FOR THAT VERY CAREFULLY."

24-JLY-1317 MON686 MOND

CONTINUED ON - NREI

CONTINUED FROM - NRDF

P

QUOTES - SEE AAQA 1731

NREI

THATCHER SEES =4 LONDON

THATCHER ALSO SAID SHE WAS ALSO NOT OVERLY WORRIED ABOUT THE HIGH LEVEL OF U.K. PRIVATE BORROWING, WHICH HAS CONTRIBUTED TO RECENT U.K. BOND, CURRENCY AND STOCK MARKET JITTERS.

"YES, BANK LENDING IS COMPARATIVELY HIGH. BUT LET'S LOOK AT THE WHOLE LENDING IN THE ECONOMY. GOVERNMENT BORROWING HAS GONE DOWN, RIGHT DOWN, TO LESS THAN ONE PCT OF OUR NATIONAL INCOME."

"THAT'S LEFT ROOM FOR BORROWING IN THE PRIVATE SECTOR ... IT WAS INTENDED TO," SHE SAID.

"BUT IF YOU TAKE THE WHOLE OF LENDING -- BOTH TO GOVERNMENT AND THE PRIVATE SECTOR -- YOU'LL FIND THAT, TAKEN AS A WHOLE, IT'S SLIGHTLY DOWN," SHE ADDED.

24-JLY-1319 MON688 MOND

REUTER

CONTINUED FROM - NREH

P

QUOTES - SEE AAQA 1731

jn.3

CONFIDENTIAL

FROM: S A ROBSON
DATE: 11 JULY 1988

CHIEF SECRETARY

cc Chancellor
Mr Anson
Mr Burgner
Mr Turnbull
Mr Sutton
Mr Evans
Mrs Edwards
Mr Call

PMP

CHIEFTAIN AGREEMENT

Mr Younger's minute of 8 July offers the Prime Minister a draft reply to a letter from Sir David Plastow (Chief Executive, Vickers). Plastow has been lobbying for an early decision to buy Vickers Challenger tank to replace the Army's existing Chieftain tanks.

2. The Treasury has not seen Plastow's letter to the Prime Minister. Plastow phoned me when he was about to send it and told me the general drift - which was a moan about the length of time MOD are taking to reach a decision. I have some sympathy with him on this. That said this is potentially a £1 billion contract and it needs to be properly assessed.

3. On this score there is one worry. The tone of Mr Younger's letter to the Prime Minister is that Chieftain is to be replaced. In his second paragraph he talks about this being "essential".

4. This prejudges the issue. There are overtones of the Type 23 debate. Mr Younger much prefers to avoid hard analysis.

5. I have agreed some time ago with his officials that there must be proper justification of replacement. The analysis has to start from the baseline of non-replacement. Non-replacement would mean keeping chieftain with some relatively minor enhancements.

6. In view of the tone of Mr Younger's letter it would be worth reiterating this baseline in a letter from your private secretary.

CONFIDENTIAL

7. As regards to draft to Plastow, this is acceptable. It can be read in a way consistent with the do nothing option.

8. I attach a draft.

SAR

S A ROBSON

jn.3a

DRAFT LETTER FROM PS/CHIEF SECRETARY TO PS/DEFENCE SECRETARY

CHIEFTAIN REPLACEMENT

1. The Chief Secretary has seen your Secretary of State's minute of 8 July to the Prime Minister.

2. The Chief Secretary fully shares you Secretary of States view that Ministers need to be in a position to make a properly informed decision on this issue. The Chief Secretary considers that this will involve, inter alia, a clear analysis of the cost-effectiveness of replacement by comparison with the alternative of enhancing Chicftain.'

3. On this basis the Chief Secretary has no comments on the draft letter to Sir David Plastow.

4. I am copying this to the Prime Minister, to the Secretary of State for Trade and Industry and to Sir Robin Butler.

J R

CHIEF SECRETARY

SECRETARY OF STATE

REC. - 8 JUL 1988

Mr Robson
CX Mr Anson
Mr Burgner
Mr Turnbull
Mr R J Evans Mr Call

MO 26/4L

PWP

PRIME MINISTER

CHIEFTAIN REPLACEMENT

Sir David Plastow wrote to you on 13th June seeking a meeting to discuss a Vickers Defence Systems proposal for the replacement of the Army's ageing Chieftain tanks. He was particularly concerned about how any delay in our decision might affect the company's export prospects and keeping together his potential overseas sub-contractors. You sent a holding reply on 18th June.

2. The background is that a combination of improved Soviet tanks, and the later timescale now envisaged for any revolutionary changes in tank armament, make it essential to replace our 600 plus Chieftain tanks, which entered service in 1965, as soon as we sensibly can. I made provision for this in the last re-costing of the defence programme and we have since been examining the Vickers proposal, which is for an improved version of our other and newer main battle tank (MBT) Challenger with a new turret and gun, and also improved versions of the current German and American MBTs, the Leopard 2 and Abrams M1A1.

3. This involves a major exercise in judging the operational merits of the various contenders, assessing technical risks and establishing the preferred procurement route, as well as seeking the price data on which to make a sound financial appraisal. But there are two further and major complicating factors.

SECRETARY OF STATE

4. The first is the extent to which our eventual choice should be influenced by the need to achieve greater interoperability with our NATO allies on the Central Front. Both Chieftain and Challenger have 120mm rifled bore guns which our current plans envisage will be replaced with an improved version. Both the US and FRG have equipped part of their tank fleets with 120mm smooth-bore guns although the Belgians on our flank have no plans to do so. The question of interoperability is a complex one but it is clearly desirable that we should make progress towards the goal of greater interoperability within the Alliance, if this can sensibly be done. The difficulty is that to change from a rifled bore to a smooth-bore gun for the planned replacement of our Chieftain tanks would mean that the new tanks could not fire the same ammunition as the Challenger tanks on which we should still be relying for a substantial part of our front-line capability in Germany and all our war maintenance reserve. This would have very serious operational, logistic, support and training problems for BAOR with attendant financial penalties.

5. One way out of the difficulty would be to replace or re-turret our Challenger tanks as well as replacing Chieftain. This would be expensive, and re-turreting would mean technical risk and delay. I am looking into this, while at the same time seeking to confirm our Allies future plans for their tank fleets, to review the prospects for collaboration and to obtain a considered view from SACEUR as to where he considers his military priorities lie in relation to interoperability.

6. The second major issue concerns the acceptability, or otherwise, of overseas purchase. Vickers are now our sole tank manufacturer and the design authority for much of our present heavy armoured vehicle inventory. A decision to buy overseas would represent a watershed decision for this area of industrial capability, including its ability to support the current heavy armoured fleet.

SECRETARY OF STATE

7. The whole question of Chieftain replacement is, therefore, a difficult and complex one. It is not something we can rush if we are to make a properly informed and sensible decision. Having reviewed the position in some detail, I expect to have the views of SACEUR and confirmation of the Allies plans shortly, together with revised cost data for all three tanks. Although I do not expect to be in a position to make firm proposals to colleagues before the Autumn, I would hope to be able to seek an earlier indication of colleagues views on some of these issues before the recess.

8. There remains the question of what to say to Sir David, who has been lobbying hard for an early decision. Our own view of the export prospects of the Vickers tank is that they are not such as to justify rushing our decision. It is true that Vickers have sunk several million pounds of their own money into what must remain, for the present, a private venture investment; and Sir David is naturally anxious to recoup this. He has already been told by David Trefgarne that we have no basis for refunding this expenditure until a decision is made to adopt the Vickers contender (if this should indeed be the outcome), although we would then look sympathetically at what could be properly reimbursed. David went over the timing with Plastow at the end of May when Sir David agreed to submit a revised Vickers offer predicated the assumption that we would not be able to let a contract before the beginning of December.

9. In sum, we are as anxious as Sir David to reach a decision, but the problem is complex. Not all the pieces are yet in place and, as I have said, I will wish to give colleagues a proper opportunity to contribute their own views shortly. Sir David's concerns are well known to us; he is equally aware of the issues we have to consider. The only substantive benefit in your agreeing to see him now, therefore, would be that it would give Sir David reassurance that his concerns had been registered at the highest level. On balance it

SECRETARY OF STATE

would seem preferable to wait until after my approach to OD colleagues; the suggested draft rely to Sir David attached to this minute takes this line.

10. I am sure I do not need to remind you, that the admirable and energetic way the company has set about re-vitalising the former Royal Ordnance operation at Leeds should not obscure the fact that Vickers bought the business without any commitment whatever to additional MOD orders beyond the current Challenger order due to complete early in 1990.

11. I am sending a copy of this minute to the Secretary of State for Trade and Industry, the Chief Secretary and to Sir Robin Butler.

G.Y.

Ministry of Defence
8 July 1988

DRAFT LETTER TO SIR DAVID PLASTOW FROM THE PRIME MINISTER

I have now had the opportunity to consider further with George Younger your letter of 13th June about the replacement of the Chieftain tank.

2. You will know from your own discussions with David Trefgarne that we are very conscious of the efforts you have made to see that Vickers will be in a position to respond speedily as and when our requirement is confirmed. At the same time, we will have to satisfy ourselves that whatever solution we adopt represents the best value for money. In coming to our decision, we shall consider the full range of factors we would expect to influence any major procurement decision, namely how well the various options open to us meet the operational requirement, the price, delivery and so on - and, of course the industrial dimension. There is also the important question of interoperability both within the British tank fleet and with our NATO allies which we shall need to consider.

3. This is an important decision and we intend to get it right. There will be no unnecessary delay on our part but equally it is not something we can afford to rush. I know David Trefgarne well understands your difficulties including those with your potential sub-contractors and he is grateful for your prompt response,

following his meeting with you at the end of May, in revising your own proposals to match what looks like a more realistic timescale, pointing to a decision in the late Autumn and before the end of the year.

4. The MOD is fully seized of the importance to Vickers and its export prospects of a timely Chieftain replacement decision. In the end, the Government's decision will rest on which of the various options best meets defence needs, price competitiveness and the kind of contractual terms offered. While I am prepared to meet you if you wish, I suggest that, unless there is some other argument affecting your company that you have not yet put forward to George Younger or his colleagues, it would be better to defer a meeting until I and my colleagues have been able to carry our consideration further forward.

001/3298

CONFIDENTIAL

cc:
Chancellor
Mr Anson
Mr Burgner
Mr Turnbull
Mr Robson
Mr Sutton
Mr Evans
Mrs Edwards
Mr Call

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Brian Hawtin Esq
Private Secretary
to the Secretary of State for Defence
Ministry of Defence
Main Building
Whitehall
London
SW1

→ Jonathan

12 July 1988

Dear Brian,

CHIEFTAIN REPLACEMENT

The Chief Secretary has seen your Secretary of State's minute of 8 July to the Prime Minister.

The Chief Secretary fully shares your Secretary of State's view that Ministers need to be in a position to make a properly informed decision on this issue. The Chief Secretary considers that this will involve, inter alia, a clear analysis of the cost-effectiveness of replacement by comparison with the alternative of enhancing Chieftain.

On this basis the Chief Secretary has no comments on the draft letter to Sir David Plastow.

I am copying this letter to the Private Secretaries to the Prime Minister, David Young and Sir Robin Butler.

Yours,

Jill Rutter

JILL RUTTER
Private Secretary

CONFIDENTIAL

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

11 July 1988

CHIEFTAIN REPLACEMENT

The Prime Minister has seen the Defence Secretary's minute of 8 July about the letter from Sir David Plastow concerning the Vickers' proposal for the replacement of Chieftain tanks. She has agreed to write to Sir David, and I enclose a copy of her letter. At the same time, the Prime Minister has commented that she can see why Sir David is worried, and she hopes that we shall make the decision on the Vickers' replacement as speedily as possible, perhaps in the early autumn.

I am copying this letter to Neil Thornton (Department of Trade and Industry), Jill Rutter (Chief Secretary's Office) and to Trevor Woolley (Cabinet Office).

CHIEF SECRETARY	
REC.	11 JUL 1988
ACTION	Mr Robson
COPIES TO	Cx. Mr Anson,
	Mr Burgner,
	Mr Turnbull,
	Mr CJ Evans, Mr Call

(C. D. POWELL)

Brian Hawtin, Esq.,
Ministry of Defence.

CONFIDENTIAL

10 DOWNING STREET

LONDON SW1A 2AA

THE PRIME MINISTER

11 July 1988

Dear Sir David,

I have now been able to consider further with George Younger your letter of 13 June about the replacement of the Chieftain tank.

You will know from your own discussions with David Trefgarne that we are very much aware of the efforts you have made to see that Vickers will be in a position to respond speedily as and when our requirement is confirmed. At the same time, we will have to satisfy ourselves that whatever solution we adopt represents the best value for money. In coming to our decision, we shall consider the full range of factors: how well the various options open to us meet the operational requirement, the price, delivery and so on - and of course the industrial dimension. There is also the important question of interoperability both within the British tank fleet and with our NATO allies which we shall need to consider.

This is an important decision and we intend to get it right. There will be no unnecessary delay but equally it is not something we can afford to rush. We well understand your difficulties, including those with your potential sub-contractors and are grateful to you for revising your own proposals to match what looks like a more realistic timescale, pointing to a decision in the late autumn and before the end of the year.

We are all fully seized of the importance to Vickers and its export prospects of a timely Chieftain replacement decision. Equally you will understand how important it is to us to weigh up properly which of the various options best meets defence needs, price competitiveness and the kind of contractual terms offered. While I am certainly ready to meet you, I wonder whether it would not be best to defer this until we have taken our own consideration of the issues involved a further step forward in the autumn.

Yours sincerely

Margaret Thatcher

Sir David Plastow

dti

the department for Enterprise

The Rt. Hon. Lord Young of Graffham
Secretary of State for Trade and Industry

The Rt Hon George Younger MP
Secretary of State
Ministry of Defence
Whitehall
LONDON
SW1A 2HB

Department of Trade and Industry

1-19 Victoria Street
London SW1H 0ET

Switchboard
01-215 7877

Telex 8811074/5 DTHQ G
Fax 01-222 2629

CH/EXCHEQUER
REC. 21 JUL 1988
ACTION CST
COPIES TO

21/7

Direct line 215 5422
Our ref LQ3ABG
Your ref
Date 21 July 1988

Dear George,

We exchanged correspondence in May regarding the handling of the Stage 1 report of the Independent Review of Defence Radio Frequency Spectrum submitted by the Chairman, Sir Kenneth Corfield.

We agreed that the initial announcement of the receipt of the report, and our intention to publish an abridged version, should be made by one of my Ministerial colleagues in DTI. I am proposing to announce the Government Response in the same manner, timed to coincide with the publication of the abridged report. I would be grateful if you could let me know if you are content with this course of action. A copy of the text of the Response is attached.

I am copying this letter to the Prime Minister, Nigel Lawson, Douglas Hurd and to Sir Robin Butler.

Yours
David

OFFICIAL RESPONSE TO THE INDEPENDENT REVIEW OF DEFENCE RADIO FREQUENCY SPECTRUM (470 MHz to 3400 MHz)

1. A published version of the Report of the Defence Spectrum Review Committee has been made available and copies have been placed in the Library.

2. The Government accepts, and will act in accordance with all the recommendations of the Committee.

3. The Government is glad to see the Committee's recognition that the overall balance of military and civil apportionment of the part of the spectrum under review is about right and that the management of the apportionments should continue without change.

4. The Committee's recommendations concerning increased civil sharing of several frequency bands managed by the Ministry of Defence will necessitate further work to determine the precise geographical and frequency constraints and the appropriate management techniques. Also, measures must be devised to ensure that, when necessary, the Ministry of Defence can quickly gain exclusive access to previously shared frequencies.

5. The Committee's other recommendations concerning greater openness about defence use of the spectrum and the use of automatic data processing are already being acted upon.

6. Finally, the Government expresses its appreciation for the work of Sir Kenneth Corfield and his colleagues and the positive nature of their report.