PREM 19/711

Economic Strategy.

Pay and Prices Monthly Economic Report.

The Economic Project.

Treasury Weekly Briefs. PART 15

Economic Policy

Part 1: May '79

Part 15: March '82

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~29.3.82~~							
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PART 15 ends:-

E(82)42 30/4/82

PART 16 begins:-

Treasury Brief 10/5/82

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
MISC 14(82) 5	19.4.82
CC (82) 19th Conclusions, Minute 2	22.4.82
E(82)42	30.4.82

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed CWayland Date 16 August 2012

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and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 26 April, are sidelined.

M M Deyes

M M DEYES

RGA

R I G ALLEN

30 April 1982

EB Division
H M Treasury
01-233-3364

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation and promotion of enterprise and initiative. Reduction of inflation requires maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Falkland Islands: Cost/Financing of operation?

No cash ceiling on the cost of the operation; needs of task force must and will come first. When the cost is known we shall decide how to deal with it. But cost can and will be met in ways consistent with Government's economic strategy. [IF PRESSED: Not all of cost will be additional. At this stage, extra cost represents very small proportion of (over £14 billion) Defence Budget. No cash or budgetary problem immediately in prospect. Also complete nonsense to suggest that ability to respond to Falklands crisis has been weakened by Government's so-called cuts in defence spending. Government has actually increased defence spending by over 85 per cent in cash terms and about 11 per cent in real terms since 1978-79.]

3. Financial markets right to be worried by Falklands crisis?

No. Of course, markets are preoccupied with the dispute but it needs to be kept in perspective. UK is basically in a strong financial position: inflation is coming down; interest rates were falling before the crisis; balance of payments remains healthy; output is recovering. Disturbance due to Falklands dispute small in relation to overall macro-economic picture. And the basic strengths in the economy have not changed (see Section J for latest interest rate position).

4. Contribution made by 9 March Budget to economic strategy?

Budget continues Government's medium-term strategy for economy. Designed to make further progress on inflation and restore base for economic growth, improved output and increased employment. Tax cuts and other measures designed to help both business and individuals, within responsible fiscal framework.

5. Not enough help for industry?

Main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates. In addition, specific Budget measures aimed at industry and business will cost about £1 billion in 1982-83. Signs of recovery in profits and financial position of industrial and commercial companies. (See also Section P).

6. Budget did more for industry than for people?

Help to industry is help to people. Higher allowances and thresholds more than compensate for inflation in last year and make up some of ground lost last year. Many other smaller changes (eg on charities) will help particular groups of people.

7. Effect of Budget on personal incomes, incentives etc?

See Section D.

8. PSBR for 1981-82 only £8½ billion. Deliberately under-stated in 1982-83 FSBR?

See Section H.

9. Does this imply too tight fiscal policy?

Had PSBR been higher, so too would have interest rates. Important question now is what level of PSBR for 1982-83 is acceptable in terms of interest rates.

10. Scope for tax cuts in view of £8½ billion PSBR in 1981-82?

See D5.

11. Monetarism dead?

'Monetarism' a much over-used, misused and misunderstood word. Medium-term framework provides essential reference point for policy, but not being slavishly and dogmatically adhered to. Only right to take account of changing circumstances: that is what we have done. Such adjustments do not reflect any weakening in resolve to tackle inflation.

12. Government's impact on inflation disappointing?

Judged by results, policy is succeeding. 12-monthly inflation rate now 10½ per cent (March figure published 23 April) - down from 11 per cent in February. Single figure inflation rate expected well before end of year.

13. Economic recovery in doubt?

[February industrial production figures, published 15 April, show only relatively modest recovery from strikes/severe weather affecting December/January levels; industrial production still at broadly same level as last autumn]

No. Underlying levels of output above that of last Spring. Most forecasters, along with FSBR, expect continuation of recovery this year; and some see growth accelerating in 1983 (see also Section B).

14. Outlook for unemployment?

Budget forecast shows continuation of recovery; not the practice to publish estimates of the overall effects of the Budget, or its individual measures, on employment or output. (See also Section C)

15. Government not keeping to commitments to reduce expenditure?

Increases announced in Budget offset by reductions leaving totals still around £115 billion. FSBR shows declining ratio to GDP in future years. (See also Section E).

16. Armstrong/unified Budget?

[Reports in Press of TCSC draft of their report.]

Proposals have wide implications. Need careful consideration. Government does take account of tax and expenditure when taking decisions on each. Await TCSC report with interest.

17. Status of forecasts run through Treasury model?

[cf S Brittan article FT 29 April.]

No guarantee of good quality necessarily arises from running a forecast through the Treasury model. Model cannot be applied mechanically; results depend crucially on judgements involved.

BULL POINTS As at 30.4.82

(i) Activity recovered by 1 per cent during 2H 1981. Most recent major independent forecasts see the prospect of recovery in 1982.

(ii) Earnings and settlements. Increases halved in 1980-81 pay round. Public sector in line. There is a good deal of evidence that average settlements in private sector are running lower than in the 1980-81 round. [CBI pay data bank for manufacturing settlements suggests average is now around 7 per cent compared with 9 per cent in previous round.]

(iii) Manufacturing productivity. Output per head rose 10 per cent during 1981. Output per head and output per person 3½ and 6½ per cent higher than previous peak in 1H 1979.

(iv) Unit labour costs: Pay moderation and higher productivity has meant dramatically low increase in manufacturers unit wage costs over last year - about 3 per cent in 3 months to February 1982 on a year earlier. Recent rate of increase below the average of our major competitors and comparable to that of Germany and Japan.

(v) Competitiveness. Cost competitiveness improved by over 10 per cent during 1981, reflecting pay moderation combined with exchange rate fall.

(vi) Profits: Industrial and commercial companies gross trading profits (excluding N.Sea and net of stock appreciation) rose strongly during 1981, up over 25 per cent between 1H and 2H 1981.

(vii) Exports have held up better than many feared (but low January figures have undermined earlier favourable comparison - non oil exports Sept '81 to Jan '82 up only 1 per cent in 1980). Engineering export orders up 17 per cent in 1981 on 2H 1980 to reach their highest level.

(vii) Unemployment. Rate of increase in unemployment has slowed further this year to just 1/4 that of a year earlier. Vacancies improved since mid 1981. Short-time working in manufacturing reduced by over ¾'s since January 1981 and overtime working has increased.

(ix) Special employment measures. Total provision on Job Release Scheme, Temporary Short-Time Working Compensation and Community Enterprise Programme in 1982-83 now planned to reach over £520 million, with additional £61 million for young worker scheme (starting January 1982). Spending on Youth Opportunities Programme to rise to £700 million in 1982-83. 280,000 unemployed school-leavers last year found places on YOP by Christmas.

(x) Training. Over next 3 years £4 million to be provided to bring training schemes up to date. New Youth Training Scheme for school leavers to be introduced September 1983 represents major step towards comprehensive provision for young people.

(xi) Industrial relations. Number of strikes in 1980 and 1981 less than in any year since 1941 and number of working days lost only a third of average of last ten years.

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(xii) Inflation. Increase in RPI more than halved since peak (21.9 per cent) in Spring 1980. 12 monthly RPI increase in March of 10.4 per cent. Wholesale price inflation in single figures - 9½ per cent in year to March.

(xiii) Share Ownership Schemes: Number of schemes has increased from 30 in May 1979 to over 400. Number of employees covered roughly doubled between first and second years in office. Profit sharing schemes alone now cover some 270 thousand employees.

(xiv) Examples of export successes reported in the Press include: £5 million plus order secured by Manchester firm (NEI-APE Ltd) for engines to power five petrol boats being built for Hong Kong Government via Scottish shipyard (Hall Russel and Co); computer-system for handling chemical structures bought by two Japanese pharmaceutical companies (Fraser Williams (Scientific Systems Ltd)).

(xvii) Overseas investment in UK: US direct investment in Britain amounted to stock of over $14 billion in 1980. Nearly 60 per cent of all US outward non-oil direct investment now takes place in EC - over half of that in UK. Half of all Japanese investment in the EC also comes to Britain.

(xviii) Overseas debt repayments. Official external debt reduced from over $13.3 billion at end-1981.

Innovation. Total of industrial robots in use in UK reached 713 last year; expected to pass 1000 this summer, UK is fifth in World league table of robot users.

Economic Briefing Division, HM Treasury, 01-233 3819/5809

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent position?

All three GDP measures were higher in real terms in Q4 1981 then had been earlier in year. GDP (output) in Q4 was nearly 1 per cent up on Q2 - the earlier low point.

[IF PRESSED on apparent weakening of recovery (based on November/December/January industrial production) - see 2 below.

2. Recent industrial and manufacturing production figures show resumed decline?

[Latest industrial and manufacturing production figures show upward revision to January's index removing decline shown last month and some bounceback in February's index to level of last November.].

Latest figures (including revisions) show that as expected February saw some recovery from weather and strike effected levels at turn of year; and that effect of these in January was less than earlier presumed. CSO's press notice clearly states that underlying level of output above low point of spring of last year. Industrial and manufacturing output in 4Q 1981 some 2-3 per cent above low point earlier in year.

3. Business opinion

[NB CBI's Quarterly Industrial Trends Survey for April to be published Wednesday 5 May.]

March business opinion surveys show encouraging improvement. CBI's monthly enquiry saw further improvement in order books, and rise (to 4 per cent) in net balance of firms expecting to increase output in next four months. FT business opinion survey corroborates this, and shows increased business optimism.

4. Other evidence of improvement in economy?

See Bull Points (following Section A).

5. Government assessment of prospects

[FSBR forecast (9 March) assesses recovery to have begun. Main points are:

	per cent increase on year earlier	
	1982	1983 H1
GDP	1½	2
Manufacturing output	3	2
Consumers expenditure	½	½
Investment (private sector and public corporation)	4½	5
Exports	3½	3

Forecast expects some stockbuilding in 1982, Government expenditure flat.]

FSBR forecast sees prospect of some recovery continuing into 1983. (Last two Government assessments of economy were broadly correct). Healthy rise in private sector investment and exports. Inflation well into single figures (7½ per cent) by mid 1983. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

6. Outside forecasts

[GDP profile in major post-Budget assessments:

	NIESR (March)	LBS (March)	St James (March)	Phillips & Drew (April)	CEPG (April)	FSBR (March)
Per cent change 1982 on 1981	+1½	+1½	+1¼	+1¾	-½	+1½]

Nearly all see prospect of continued recovery in 1982 in line with FSBR, (as always, a range, with Cambridge forecast (CEPG) being the more pessimistic) and see inflation at 8-9½ per cent by Q4 1982 - also in line with FSBR. [See also C4 (unemployment), K4 (inflation) and L10 (balance of payments).]

7. Cambridge Economic Policy Review gloomy forecast?

[Document published 26 April gives base projection and assessment of results alternative policies.]

Base projection is, as usual, somewhat out of line with both the FSBR and other forecasts (more pessimistic on growth and more optimistic on inflation; notably CEPG forecasts for output and exports in 1981 were well wide of the mark - predictably, on side of pessimism. Analysis of alternative policies supports view that even substantial reflation would produce few jobs - £30 billion over 3 years estimated to reduce unemployment by 300,000 after 2 years, thereafter gain starts to be reversed. CEPG also admit that reflation 'is not in itself capable of generating sustained recovery'.

C LABOUR MARKET

1. Recent unemployment figures?

[Unemployment (UK adult seasonally adjusted) rose by 28,000 to 2,850,000 (11.9 per cent) in April. Total unemployment rose by 15,000 to 3,008,000 (12.6 per cent). Average monthly underlying increase in adult unemployment (after allowing for men over 60 transferring to long term Supplementary Benefit) are:

1980 Q4	Q1	Q2	Q3	Q4	First 4 months
105	77	62	51	33	23]

April's rise (though higher than very low increases in February and March) suggests further slowing down of rise in unemployment this year.

2. Vacancy figures disappointing?

[Vacancies (UK seasonally adjusted) fell slightly for second consecutive month to 110,000 in April, compared with 113,000 in February. Vacancy flow data for March (latest month available) show continued rise in outflow.]

Despite slight falls in last two months, vacancies still ¼ higher than at low point in Q2 1981 and flow (ie vacancy turnover) has improved.

3. Effect of Budget on unemployment?

Budget contributes to Government strategy of fostering conditions for sustainable growth. Help to business will lay foundation for more real jobs. Employment will benefit from some further improvement in activity. Proposed new non-profit-making scheme will enable local authorities and voluntary sponsors to provide many new jobs. (MSC to advise what possible: for illustration, Government prepared finance 100,000 at net additional Exchequer cost of £150 million).

4. Unemployment expected to continue rising rapidly?

[Outside forecasters see continued rise in registered unemployment during 1982 reaching about 3 million (UK adults) in Q4. Opinion divided for 1983; some (CEPG, Cambridge Econometrics, ITEM, NIESR) see rise continuing but at a slower rate, some broadly flat (LBS, St James) others (P&D, S & Coats) expect slight (roughly 50-100,000) fall in 1983. Liverpool foresee fall of 400,000.]

Unemployment forecasts uncertain; independent forecasters encompass differing views for 1983 - several projecting stabilisation, some [a slight] decline. Rise in unemployment drastically reduced since end 1980. Clear evidence of further slowing down this year - Q1

1982 rise just 1/5 that in Q4 1980. Vacancies, short time and overtime all improved last year. Employment situation will benefit from some further recovery in activity this year.

5. CEPG expect 4½ million unemployed by 1990?

As always there is a range of unemployement forecasts, with CEPG amongst most pessimistic (see parenthesis to 4 above). Notably, CEPG unemployment forecasts now less pessimistic than a year ago.

6. Government forecasts for unemployment

[1982 PEWP uses working assumption of an average level of 2.9 million unemployed in Great Britain (excluding school leavers) in 1982-83 and rest of survey period. School leavers, adult students, temporarily stopped and Northern Ireland imply UK total unemployed of 3.2 million in 1982-83.]

Very difficult to forecast. Following well-established precedent of previous administrations is not publishing. Public Expenditure White Paper figures are planning assumptions not forecasts.

IF PRESSED that PEWP figures show Government planning sustained higher level of unemployment: No. Maintaining constant figure for the Survey period is conventional assumption adopted by previous Administration. PEWP figures consistent with the prospect of some fall in total unemployment before the end of 1982-83. They do not however necessarily imply this. If things go well - eg lower pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.

7. Employment continuing to fall?

[Total employment declined 1.9 million or 8 per cent in 2 years to Sept 1981. Provisional Q4 figures indicate decline of about 200,000 compared with 150,000 in Q3 and 300,000 per quarter in H1 1981.]

Decline in H2 1981 almost half that in H1. Other labour market indicators improving (see C1, 2 and 4 above).

8. Unemployment higher than in other countries?

[On standardised definitions in 3Q 1981 UK employment was 11½ per cent compared with 6¾ per cent OECD rate; a UK doubling compared with an OECD rise of a third since 1979.]

Whole world affected by rising unemployment. In our case we have additional self inflicted wounds of high pay awards and low productivity. Unemployment now rising very fast in some countries eg Germany.

9. High Exchequer costs of unemployment? Recent Treasury estimates suppressed?

[Mr Varley in interview LBC 26 April suggested £15 billion a year.]

No 'right' figure. Estimates depend critically on assumptions used, the causes of unemployment and items of 'cost' covered. [IF PRESSED: Estimates have been made of cost of additional registered unemployment (eg for 1980-81 in February 1981 EPR). Attempt made to update to 1981-82 - range of figures has been calculated. But doubts expressed about assumptions used. Work, therefore, continues. No decision whether to publish.] Cannot gross up such figures to produce total cost (in terms of lost taxes and extra benefits) of all the unemployed. Meaningless concept. Implies comparison with an economy with zero unemployment. Can say total expenditure on unemployment and supplementary benefits paid to the unemployed estimated at £4.3 billion in 1981-82 and £5 billion in 1982-83.

10. What is Government doing to provide more jobs?

Illusion to think Government can switch employment off and on like a tap. Government pursuing sensible fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless Government expanding schemes to meet special difficulties and improve training - eg plan to spend £1½ billion in cash on 1982-83 (40 per cent more than in 1981-82) on special employment and training measures; new Youth Training Scheme costing £1 billion a year from 1983-84; and new measure announced in Budget. (See C3).

D TAXATION

1. Burden of taxation

[Total taxation (i.e including for example income tax, indirect taxes, corporation tax, rates and NIC) in 1978-79 was 34½ per cent of GDP (at market prices), 36 per cent in 1979-80, 37½ per cent 1980-81. It is forecast to be 40 per cent in 1981-82 and 39½ per cent in 1982-83.]

This has inevitably increased during a time when the recession has been adding to public spending. Changes proposed in Budget will reduce total burden next year compared with 1981-82. [NB: Not true of burden on persons.]

2. Burden of tax has risen for most households since 1978-79?

[Comparisons given in Parliamentary Answers to Mr Straw 3 December, 17 February and 18 March col W199.]

Slow growth of output and difficulty of restraining public expenditure have inevitably meant higher tax burden. But real personal income after direct taxes still higher than under last Government. And more honest to raise taxes to finance necessary higher expenditure than to increase borrowing, with the increased interest rates and inflation that would bring.

3. Burden has fallen for the rich?

Only because of abolition of absurdly high marginal rates and raising of thresholds in 1979 Budget.

4. Burden has risen most for the poor?

Proportion of income paid in income tax and NICs will <u>fall</u> next year (82-3) for lowest paid taxpayers. And low paid with children entitled to benefits such as FIS.

5. Scope for tax cuts because of lower than expected PSBR in 1981-82?

No reason to believe that PSBR in 1982-83 will be higher than forecast (see H4). Government want to cut taxes further, when economic circumstances permit, but more tax cuts too soon could jeopardise recovery.

6. Personal tax burden increased by recent Budget - when NICs taken into account?

[Full explanation given in Parliamentary Answer 11 March OA col 955].

The real increase in personal allowances and tax thresholds will <u>reduce</u> income tax as a percentage of income at all levels of incomes. Those over pension age who are taxpayers will benefit from income tax changes and will be unaffected by NIC rise, and, of course, State pensions are being uprated from November. [<u>IF PRESSED</u>: In immediate cash terms, increases in personal allowances etc will <u>compensate</u> for NIC increase for <u>majority</u> of taxpayers. Taking into account <u>increased earnings</u> in 1982-83 (for example using the

Government Actuary's 7½ per cent assumption) percentage of income paid in income tax plus NIC will rise for most people, but will fall for the lowest paid (below about ½ average earnings (married) and below about 1/3 average earnings (single).]

7. No improvement in incentives?

There will be 1.2 million fewer taxpayers than if allowances had remained at 1981-82 levels, and ½ million fewer higher rate taxpayers. For the substantial number taken out of tax or with reduced marginal rates, incentives will improve.

8. No help on poverty trap?

Numbers in Poverty Trap should not be exaggerated. Increases in income tax allowances have a beneficial impact. [IF PRESSED: overall, small increase in numbers in poverty trap (10,000) as result of FIS uprating. But this helps low paid and generally makes employment more attractive than unemployment.]

9. Poverty trap/'why work? syndrome' need investigation?

Whole question of interaction between income tax and social security benefits being examined by TCSC Sub-committee (chaired by Mr Meacher). This is a complex area; the sub-committee is a more suitable forum for discussion.

10. Budget reduction in NIS not enough to industry?

Cut welcomed by CBI and industry generally. Provides substantial help on business costs. 1 per cent reduction maximum possible without risks for PSBR: outright abolition too costly. And other measures to help business directly - energy, construction, innovation and enterprise packages plus helpful - and welcomed - improvements in capital tax regime (see also Section P).

11. Excise duties increases inflationary/harmful to industries

Increases in excise duties as a whole slightly less than broadly compensate for past year's inflation. Variations between duties take account of industrial considerations e.g supplementary increase last July on tobacco/Scotch whisky industry/help for industry by smaller increases on e.g derv - mainly used by industry.

12. Government take from North Sea oil too high?

See S1.

E PUBLIC EXPENDITURE AND FINANCE

[Public Expenditure White Paper (Cmnd 8494) published 9 March. Gives planning totals of £115.2 billion in 1982-83, £121.1 in 1983-84 and £128.4 in 1984-85. About £5 billion higher than last White Paper in 1982-83 and £7 billion in 1983-84. Net effect of changes announced in Budget is to reduce totals to £114.9 billion, £120.4 billion and £127.6 billion].

1. Public expenditure too high?

Spending in 1982-83 planned to be about £5 billion (4½ per cent) lower than intended by last Government even if higher than planned when this Government first took office. Decisions to increase spending represent flexible but prudent response to changed circumstances e.g additional spending to help young unemployed. Drive to improve management in public sector and reduce administration expenses continues.

2. Ratio of public spending to GDP is getting back to peak levels of mid 1970's?

Ratios in 1980-81 (43½ per cent) and 1981-82 (45 per cent forecast) remain below level of 1974-75 and 1975-76 (46 per cent in both years). [NB 1981-82 ratio could be nearer 44½ per cent. See H5.] Rise in ratio in 1981-82 mainly reflects higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years: assumptions in MTFS would mean figures of 44½ per cent in 1982-83, 42½ per cent in 1983-84 and 41 per cent in 1984-85. Reflects assumed GDP growth and curbing of public expenditure. (See also H5)

3. Cuts in defence spending have weakened our ability to respond to Falklands crisis?

No. We have not cut defence spending since 1978-79. We have increased it by over 85 per cent in cash terms - a real increase of about 11 per cent - to over £14 billion. We are spending more on conventional naval forces in real terms than was spent in year before we came to office. When expenditure on modernising strategic deterrent is at its peak we will still be spending more on conventional Navy than in 1978-79.

4. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term. If increased spending not financed responsibly, would soon lead to more inflation. If financed prudently, would lead to higher interest rates and/or higher taxes. We are responding, within limits of prudence, to needs of current circumstances.

5. Real terms comparisons

No volume equivalents of cash plans. But cash increase in plans between years is 9 per cent in 1982-83, 5 per cent in 1983-84 and 6 per cent in 1984-85 (and projection of GDP deflator in MTFS is rather lower than this in 1982-83, rather higher in 1983-84 and about same in 1984-85). So in cost terms [i.e cash inflated/deflated by general movement in prices] there is an increase in 1982-83, a decrease in 1983-84 and a small decrease in 1984-85.

6. Plans unrealistic, given e.g overspending in 1981-82/future rates of inflation?

Total spending in 1981-82 expected to be only a little [NOT FOR USE: 0.4 per cent] higher than planned a year ago. Major reason for overspending is present level of spending by local authorities; this has been taken into account in plans. Realism, particularly in respect of local authorities and nationalised industries, is one reason why plans for future years are higher than in previous White Paper. Large Contingency Reserves due to greater uncertainty in later years and designed to give realistic planning totals.

7. Higher inflation than allowed for in PEWP may raise public spending?

True that inflation assumption in FSBR slightly higher than in PEWP, but:

- for 1982-83 confident that planning total including Contingency Reserve will hold;
- for later years inflation assumption in FSBR a little higher than cost factors used in building up cash programmes;
- in due course, will consider adequacy of cash provision on programmes.

Meantime, uncertainties due to, for example, inflation, are one reason for large Contingency Reserves in later years; makes for realistic planning totals.

8. NIS reduction: effect on public expenditure?

[Programmes will be reduced to reflect reduction in NIS paid by public sector. First estimates of effect (included in post-Budget revised planning totals) is some £360 million in 1982-83 and £450-500 million in later years.]

Government's intention in reducing NIS is to help private industry, not public sector. Effect of clawback on public sector wil leave its position broadly unchanged. (See also P2).

9. Not enough capital expenditure?

Government prepared to give priority to worthwhile capital projects wherever this can be done within overall spending totals. Plans do allow for changes between 1981-82 and 1982-83 as follows:

- public sector spending on new construction increased by 14 per cent;
- nationalised industries investment to rise by 26 per cent;
- increase in housing investment output [NOTE: if LAs take full advantage of receipts from sales, gross new investment can be as high as £3 billion next year];
- slight increase in work done on water and sewerage projects even though provision reduced).

10. Cuts in capital

Some reductions in cash provision necessary, but recent falls in tender prices (following sharp increases between 1978 and 1980) will mean that programmes mainly affected (roads, water, local environmental services) should be carried out as planned. Planned capital expenditure also reflects decline in needs since early mid-1970s (e.g roads, schools). Planned spending should not jeopardise future standards and availability of public amenities and services.

11. TCSC criticise change to cash planning?

The TCSC do not dispute decision to change to cash planning. They are concerned rather with presentation of figures.

12. Cash planning means concentration on first year, not enough on services in later years?

Government recognise case for medium-term planning. But planning must be related to availability of finance as well as prospective real resources. Cannot accept unconditional commitment to forward plans for services. Volume plans formerly had to be cut when conflicted with financial constraints - e.g after IMF intervention in 1976.

13. Cash figures should be accompanied by constant price figures to give some idea of levels of service?

Constant price figures of limited value in new situation. Cash programmes intended to have primacy. Necessary to get away from old system of volume planning and destroy idea that programme managers automatically entitled to be compensated for effects of inflation by revaluing their programmes. In any case old 'volume' figures not a measure of level of service. Simply measured resources put into programmes - inputs. The level of service provided - output - takes account not only of resource inputs, but efficiency and effectiveness of their use. We are continuing to review and develop use of output measures in planning and management of public expenditure.

14. <u>End-year flexibility</u>?

Possibility of end year flexibility is being looked at again. There could be some managerial advantages in such a scheme. But we also have to consider question of cost.

15. <u>Cash limits 1982-83 and public sector pay</u>?

(See K10-12).

16. <u>Cut public sector pay bill/administrative costs of central government</u>?

Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on. Provision for public service pay increases next year limited to 4 per cent. Administrative costs ae not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

LOCAL GOVERNMENT

17. <u>Overspending in 1982-83? Government response?</u>

Disappointed that preliminary figures show local authorities are budgeting to spend above Government's plans. Overspending particularly to be regretted since plans are realistic. Local authorities could achieve them if they try hard enough. Government's response to combat overspending will be announced shortly. Scottish Secretary has announced that he will seek to reduce the grants of Lothian Regional Council (by £45 million) and Stirling District Council (by £1½ million). The authorities have only themselves to blame for these grant penalties. They can avoid them if they plan for more reasonable levels of expenditure.

18. Government's plans for later years are unattainable?

[Press reports have claimed that White Paper implies 9 per cent total reductions in 1983-84].

Government's plans for 1983-84 are fair and realistic - they are 4 per cent higher than for 1982-83. [IF PRESSED: if this means that LAs are faced with need to make substantial economies, reason will be LA's overspending in 1982-83].

19. Large rate increases this year are Government's fault?

Not at all. If local authorities had sought to spend in line with Government's plans, rate increases should be very low. Where they are high, it is because local authorities have chosen to overspend.

20. Effect of NIS reduction on local authorities?

As Chancellor announced in Budget, we intend that local authorities overall will be neither worse nor better off as a result of decrease in NIS. We are consulting local authorities about details. [NOT FOR USE: We are considering whether to reduce RSG or to leave NIS unchanged for local authorities in 1982-83.]

21. Green Paper on Domestic Rating System: Government response?

Government is considering carefully all representations received. We wish to produce proposals for a scheme that will remedy shortcomings of present system while commanding wide support.

F CIVIL SERVICE STAFFING AND PAY

[Functions being exercised by HM Treasury since 16 November 1981: (1) civil service manpower, pay and allowances, retirement policy and superannuation scheme, staff inspection and evaluation, (ie central allocation and control of resources), (2) responsibility for Central Computer and Telecommunication Agency and Civil Service Catering Organisation (3) civil service industrial relations. Functions being exercised by Management and Personnel Office (MPO): (1) civil service efficiency, personnel management, recruitment and training, (2) Office of Parliamentary Counsel (3) machinery of government questions.]

1. Civil Service too big/does too much/is over staffed?

Since the Government came to office, Civil Service has been reduced by nearly 8 per cent to 675,400. This is smallest for 15 years. This results from a reduction in functions, privatisation and improvements in efficiency. We are on course to achieve our aim of having a Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean the smallest Civil Service since the end of the war.

2. Civil service pay: non-industrial civil servants

[Settlement date 1 April 1982. FT 30 April reports Government will implement award - worth 5.9 per cent overall - speculation.]

Negotiations failed. Matter referred to arbitration and heard by Civil Service Arbitration Tribunal on 19 and 20 April. Award made known 23 April. Government considering this, and will announce its decision on implementation as soon as possible. [NB: Announcement expected in week beginning 2 May.]

3. Civil Service pay: industrials

[Settlement date 1 July 1982]

Claim for increase in pay in line with inflation, a shorter working week and longer holidays, is under consideration.

4. Scott Report/Public sector pensions?

See K 18.

G SOCIAL SECURITY

1. Now that unemployment benefit is to be brought into tax why not restore November 1980 5 per cent abatement ?

Decision to abate UB was not simply taken as a proxy for tax but to reduce public expenditure and to improve incentives to find and keep work. (Chancellor's Budget statement in March 1980 made that perfectly clear.) Those reasons remain valid. Any improvement on rates announced would seriously worsen incentives. Cost too would be high - £60 million in a full year [net of reduced claims for supplementary benefit, but gross of tax].

2. Why cut child dependency additions to unemployment benefit?

[In line with practice in recent years, uprated level of child dependency additions to unemployment benefit (but not Supplementary Benefit) has been abated by amount of increase in Child Benefit. In consequence, CDAs will be reduced from current level of 80p to 30p next November.]

The child dependency additions to unemployment benefit are being phased out, and will eventually be replaced entirely by Child Benefit. In this we are following practice adopted by last Labour Government.

3. Increasing supplementary benefits by less than forecast movement of prices hits at poorest of the poor, and breaks an election pledge?

The benefits will retain their value in real terms. Beneficiaries receive not only their scale rate entitlement but a cash payment to cover their housing costs in full. By uprating scale rates in line with RPI which includes housing costs, there has been some double provision. The change corrects that. The abatement of ½ per cent represents a broadly based adjustment for the likely relative movement of housing costs to November 1982. [NOTE: we do not want to make public a forecast of a housing index.]

4. Death grant - increase to realistic level?

[Social Services Secretary on 3 March published consultative document about death grant, asking for comments by 30 July.]

Social Services Secretary would welcome comments on his recently published consultative document on death grant. As we have always made clear, our aim is to redistribute the resources now devoted to death grant in a more sensible fashion - we cannot afford to add to those resources.

H PUBLIC SECTOR BORROWING

1. Why was such a serious error in forecasting the 1981-82 PSBR made so near to end of year?

[1981-82 PSBR estimated outturn published in 1982-83 FSBR £10.6 billion; April 1981 to March 1982 results reported in 22 April press notice £8.6 billion. Main causes of reduction from FSBR figure were reduction in central government own account borrowing of £1.3 billion and reduction in local authority borrowing requirement of £0.4 billion.]

Forecast based on best estimates at time of 1982-83 FSBR. Always considerable uncertainties at time of Budget. Spending, and some forms of borrowing, often high and variable in March. [IF PRESSED: Always difficult to predict end-year flows of expenditure and receipts, and effects of Civil Service dispute on monitoring added considerably to uncertainties at time of FSBR.]

2. How can the Government treat the PSBR as a crucial statistic when forecasting errors of this size occur?

Importance of balance between government's spending and income recognised by all governments, whatever the difficulties of forecasting.

3. Interest rates will now fall?

Not necessarily. Many factors involved in deciding appropriate level of interest rates.

4. Won't the PSBR in 1982-83 also be lower, and doesn't this cast doubt on the Budget judgement?

[1982-83 FSBR shows forecast 1982-83 PSBR of £9.5 billion.]

Too early to say until more detail is known on last year's income and expenditure flows. Possibility of some action on the fiscal front during 1982-83, depending on economic developments, made quite explicit in Budget speech. [IF PRESSED: Not necessarily true that 1982-83 PSBR estimate would have been different had more accurate 1981-82 outturn been available. Figure of £9.5 billion was judgement of what could be financed in market at tolerable interest rates in all circumstances of time.]

5. Implications for public expenditure in 1981-82 and 1982-83?

Not known exactly what 1981-82 outturn will be nor the implications for 1982-83, as will be some time before information on 1981-82 outturn will emerge. [IF PRESSED: It is estimated, on very incomplete information, that the planning total will fall from

J MONETARY AND FINANCIAL POLICY

1. Effect of Falklands dispute on markets?

[Interest rates are fluctuating at levels about ¼-½ per cent higher than before the crisis. No sign of base rate moves.]

Markets uncertain, but initial shock seems to have been absorbed without significant ill-effect. Too early to say what long term effects will be, but Government determined not to be deflected from its path. Recent indicators good, eg RPI, money supply figures.

2. Prospects for Lower interest rates?

[Bank base rates reduced by ½ per cent to 13 per cent with effect from 12 March. Have come down by 3 per cent from peak of 16 per cent last autumn. Market rates are roughly ½ per cent higher than level just after Budget, largely in reaction to Falklands dispute].

Of course we want to see lower rates. Have seen significant reductions over past 6 months. But we must proceed cautiously if we are not to let up in the fight against inflation.

3. Will high and unstable US rates affect UK rates?

US rates not sole determinant of UK rates, but high US rates certainly an adverse development and in September were a key factor in driving our rates up. Recently, however, sterling has remained reasonably firm, probably helped by improved prospects for wage round, and good trade figures. UK interest rates have eased this year against US trend; but we cannot insulate ourselves from difficult international background.

4. Falls in interest rates since New Year incompatible with strategy?

Taking account of all evidence, present levels of interest rates are consistent with policy of continuing downward pressure on inflation.

5. MTFS being quietly shelved?

[3rd MTFS states Government's objectives 'to reduce inflation and to create conditions for sustainable growth in output and employment', by 'steady but not excessive downward pressure on monetary conditions'. Key financial indicators are the monetary aggregates and exchange rate. Target range for growth of M1, £M3, PSL2 in period February 1982 - April 1983 of 8-12 per cent. Illustrative path of 7-11, 6-10 per cent in 1983-84, 1984-85. Targets for later years to be set nearer the time.]

No. Updated MTFS is realistic and flexible, describes how monetary policy operated in practice. MTFS serves useful purpose. Right to retain and adjust in light of experience.

6. Monetary targets discredited?

Monetary targets have important role in defining medium term direction of policy. But short term movements in monetary aggregates not always reliable guide to monetary conditions. Policy decisions based on assessment of all available evidence.

7. Overshoot of 1981-82 monetary target

[£M3 grew by 0.2 per cent seasonally adjusted in banking March; annual rate of growth since Feb 1981 (ie 1981-82 target period) 13.4 per cent; M1 fell by 0.7 per cent, 7.3 per cent since Feb 1981; PSL 2 rose by 0.6 per cent, 11.7 per cent since Feb 1981.]

Growth in £M3 was above top end of 1981-82 target range, even allowing for effects of Civil Service strike. At least part of excess reflects increasing market share of banks in mortgage lending. Also reflects longer term effects of institutional changes such as ending of corset, abolition of exchange controls and changes in savings behaviour. These factors imply higher monetary growth permissible for same increase in nominal incomes. [NB. Annualised rates of growth over 1982-83 target period on basis of one month's figures would not be sensible.]

8. Monetary conditions too tight?

Behaviour of exchange rate and money GDP as well as monetary aggregates suggest financial conditions have been moderately restrictive as intended. But bank lending still high, despite level of interest rates. Companies' financial position much stronger than a year ago. (See P3)

9. Bank lending

Still very strong. Part at least is substitution for lending by building societies and other forms of consumer credit. To extent that it is additional, adds to inflationary pressure, so must avoid premature relaxation of interest rates.

K PRICES AND EARNINGS

1. Inflation still higher than when Government took office?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 14.1 per cent.]

Average level of inflation will be lower under this Government than under its predecessor. This will be the first Government since the war that has achieved a lower rate of inflation than its predecessor.

2. When will single figure inflation be achieved?

[Year-on-year rate of inflation 10.4 per cent in March compared with 11 per cent in February, and 21.9 per cent in May 1980.]

Budget forecast is for year-on-year rate of inflation of 9 per cent by Q4 1982, falling to 7½ per cent by mid-1983. We expect rate of inflation to be below 10 per cent well before end of year. [NOT FOR USE: possibility April figure below 10 per cent.]

3. What reason is there to expect a further decline in inflation?

Over the next year or so, moderation in unit labour costs should continue to exert downward pressure on the rate of inflation, as should weak commodity prices. Competitive pressures on firms to limit price rises are also likely to remain strong.

4. FSBR inflation forecast more optimistic than major outside forecasts?

Assessments released since Budget expect single figure inflation to be recorded this year (LBS, NIESR, P&D, Simon and Coats, St James). March CBI monthly trends enquiry showed, for second consecutive month, substantial decline in net balance of firms expecting to raise prices in next four months [Dec and Jan 47 per cent, Feb 40 per cent, March 32 per cent].

5. Effect of 1982 Budget on RPI?

Compared with full indexation of excise duties, direct effect of Budget is RPI reduction of 0.1 per cent (or an increase of 0.1 per cent including also the direct effect of the 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 0.8 per cent increase in the RPI (or 1.4 per cent including also 2 December measures).]

6. Effect of 1982 Budget on TPI?

Compared with full indexation of excise duties, direct effect of Budget is TPI reduction of 0.4 per cent (or increase of 1.1 per cent including also direct effect of 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 1.6 per cent reduction (or a 0.3 per cent increase including also 2 December measures).]

7. Nationalised industry prices

Nationalised industry price rises have been due in part to the ending of the previous Government's policy of artificial and distortionary price restraint. But since middle of 1980-81, gap between NI price increases and RPI has narrowed. [See R12]

8. Current level of pay settlements?

In economy generally, settlements in last pay round averaged 8-9 per cent. Negotiators seem to be settling up to about a third lower in this round than they did in previous. And almost all settlements seem to be in single figures.

9. Private sector pay

[CBI figures suggest that manufacturing settlements monitored since 1 August are averaging around 7 per cent.]

Settlements have been lower in recent months, reflecting an increasing sense of realism about pay. But the need is for continuing low settlements which are consistent with maintaining economic recovery and improving employment prospects.

10. Public sector pay

Government's approach to pay in the public services must take account of what the taxpayer can afford. Pay negotiations in the nationalised industries and local authorities are a matter for the parties concerned, as are the financial consequences of any settlements reached.

11. 4 per cent pay factor unrealistic/unfair?

Real incomes had risen to unsustainable level in recent years and public service pay increased relative to private sector since 1979. 4 per cent is broad measure of what Government thinks reasonable and can be afforded as general allowance in fixing the programme from which public service pay bill has to be met.

12. Nurses broken through the 4 per cent?

The 4 per cent factor is not a norm. Government recognises need for pay settlements to take account of market factors, including effect on recruitment and retention of expensively trained staff in NHS.

13. Civil Service pay?

See F2-3.

14. Average earnings index

[Year on year growth 11.3 per cent in February compared with 10.8 per cent in January, though (unpublished) underlying increase slightly less than in recent months at around 10¾ per cent.]

Recent buoyancy of earnings partly reflects increase in hours worked, which is an effect of the emerging revival of activity, particularly in manufacturing. Change over the 12 months to February straddles two pay rounds - not useful indicator of recent trends.

15. Comparison of TPI and index shows that real take-home pay has fallen over the past year

Yes. But follows growth of 17½ per cent in personal living standards in three years 1977-80.

16. Movement in TPI

Fact that TPI has been increasing faster than RPI (roughly 3¼ per cent faster over year to March 1982) reflects measures taken to restrain Government borrowing -essential if inflation is to be controlled.

17. Government aiming to cut living standards?

[Although RPDI was 1 per cent higher in 1981 Q4 than in 1979 Q1, it is likely to fall below the 1979 Q1 level during 1982]

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

18. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, evasion, administrative cost, and interference with market forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

19. Index-linked pensions and the Scott Report?

The Government is considering the whole question in the light of the Scott Report. Our aim is to ensure that public servants' pensions are fair to taxpayers, as well as to current employees and pensioners and their dependants.

L BALANCE OF PAYMENTS

1. Will the freeze on Argentine assets affect the standing of the City?

We have not confiscated Argentine's assets, merely frozen them. This action was taken under extraordinary provocation; we believe the international financial community will understand this.

2. Does the freeze involve reintroducing exchange controls?

No. We are denying Argentina access to her assets which is the reverse of traditional exchange control - which controlled payments by UK residents to non-residents.

3. Balance of advantage favours Argentina in mutual freezing of assets?

Argentine retaliation will not affect UK economy as a whole. Although UK assets in Argentina greatly exceed Argentine assets here their assets here are highly liquid. The crisis and our action will greatly reduce Argentina's capacity to raise loans on the international markets. At least two Argentine public foreign borrowing operations amounting to $400 million have been suspended since the crisis began.

4. New Argentine financial restrictions?

[Reports that Argentina to issue dollar-denominated bonds to meet some current interest payments].

Payment to UK from Argentina already suspended by the Argentines. Reports are confused on details, but Argentina is clearly looking round for devices to avoid bankruptcy. Rest of world will draw their own conclusions about the credit-worthiness of the Argentine regime.

5. January trade figures

[Published 2 April]

Current account surplus in January estimated at £348 million, continuing the trend of strong surpluses. A visible trade deficit of £132 million was outweighed by projected invisible surplus of £480 million, swollen by EC budget refunds.

6. Exports

January export figures were erratically low, probably due to bad weather during first half of month. Necessary to wait for February figures for more accurate idea of recent export trends.

7. Imports

January import figures tend to confirm trend of last quarter 1981, reflecting increased demand for basic materials and other imports together with much less destocking.

8. Why is invisible surplus projection so high?

The projected invisibles surplus of £480 million takes into account further EC budget refunds of over £800 million in Q1 1982 (see N4). Earnings of overseas oil companies operating in the North Sea are likely to have been depressed, reducing debits on the interest, profit and dividends account.

9. Balance of payments Q4 1981

Current account established to have been £1,541 million in surplus in Q4, including a visible trade surplus of £623 million. Total 1981 current account surplus £8 billion.

10. Prospects for 1982?

[FSBR projects surplus of £4 billion on current account; average margin of error is £2 billion. Outside forecasts range from near balance to £7 billion surplus.]

Very uncertain, but nearly all forecasts see continued surplus - albeit below last year's record level.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate

[Since last autumn sterling has remained broadly stable. The average £ effective rate in Q1 1982 was over 10 per cent lower than in Q1 1981. Recent lows were $1.7470 on 6 April, DM 4.07 on 20 October. Highs were $1.97 on 30 November, DM 4.407 on 9 February. Rates at noon on 29 April were $1.7819, DM 4.199 and an effective of 89.43. Reserves at end March stood at $19.0 billion, compared with $23.4 billion under the old valuation at end February.]

The Government has no target for the exchange rate. The rate is taken into account in interpreting domestic monetary conditions and taking decisions on policy.

2. Effects of Falkland Islands dispute on sterling

Hardly surprising if the uncertainties had some unsettling effect. But markets are aware that the underlying position of the UK is strong, with inflation falling, growth picking up and a healthy balance of payments surplus. The Falklands dispute is small in relation to this overall macroeconomic picture, and there is no question of it requiring any change in our basic economic strategy.

3. Bank of England intervening to support the rate?

Policy is unchanged. The Bank do intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions are unsettled. But as the Chancellor has already stated we have no target - undisclosed, secret or otherwise - for the exchange rate.

4. Concerted intervention to reduce the value of the dollar?

All the experience in recent years is that exchange rates for major currencies cannot be manipulated by intervention alone. Intervention can help to steady markets, but not counter major exchange rate trends. That takes changes in real policies, affecting interest rates, monetary conditions and fiscal policies. Lower US inflation is in everyone's interest: the matter for real concern is the US fiscal/interest rate mix, a problem all countries are familiar with.

5 Sterling should join the EMS?

[See N10-11]

6. Lower the exchange rate to help UK competitiveness?

Effective exchange rate is now about same as when Government came to office. So any loss of competitiveness since then is entirely due to our paying ourselves more than we can afford. Only way to achieve lasting gains in competitiveness is by cutting inflation and bringing costs under control.

7. Why has revaluation of reserves led to such a large fall?

[Revaluation reduced reserves from $23.2 billion to $19.0 billion, a reduction of $4.2 billion.]

Because of the rise in the dollar since March 1981 the value of our non-dollar convertible currency holdings as expressed in dollars is less. At the same time the value of each dollar's worth of reserves is more. Similarly the dollar price of gold has fallen considerably in value over the past year. (Gold held in the reserves (other than that swapped for ecus) has been revalued at 75 per cent of the final fixing price on 31 March, according to the usual formula used in the annual revaluation.)

8. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to $14 billion by end of 1981. This has been more than achieved - external debt is now around $13½ billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. 'Mandate negotiations'

Foreign Ministers continued their discussions at their meeting on 27 April. The Foreign Secretary impressed on our partners the need for a settlement which was fair for both Britain and the Community. There will be further contracts with the Presidency and the Commission in preparation for a further discussion by Foreign Ministers in the near future.

2. Link with CAP prices?

All member states agreed that the three chapters of the mandate (development of Community policies, agriculture and the Budget) must be taken together. The agricultural chapter and the budget chapter will therefore be carried forward in parallel.

3. Net UK contribution to community too high?

A lot lower than it would have been without the refund agreement of 30 May 1980.

4. UK refunds in respect of 1981

Commission paid us before 31 March £813 million for supplementary measures as first instalment of our refunds in respect of 1981. This represents 81 per cent of our entitlement for that year. Our net contribution for 1981-82 is now put at some £200 million - very substantially less than it would have been without the 30 May 1980 budget agreement.

5. UK a net recipient in 1981?

[Commission's latest estimates suggest that we were small net beneficiaries in 1981]

On our figures, we remained a small net contributor to the allocated Community budget. We also, of course, contribute to aid etc. which is part of the unallocated budget. Very satisfactory that the outturn was better than expected: for we remain one of the less prosperous member states.

6. Will UK have to repay or forego refunds if net contribution less than originally estimated?

The UK is clear that minimum net refunds payable under 30 May agreement are 1175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

7. Do supplementary measures grants lead to additionality?

There is additionality in that refunds enable public expenditure in the regions and elsewhere to be higher than would otherwise have been possible.

8. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

9. Costs of CAP to UK consumers

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

EUROPEAN MONETARY SYSTEM

10. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

11. Join the EMS for exchange rate stability?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

P INDUSTRY

1. Budget does not do enough for industry?

Budget measures directed at helping business and will cost £1 billion in 1982-83. On indexed basis over 2/3 of Budget's net revenue cost will go to help businesses. But main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates.

2. Prospects for industry-recovery?

Fall in output has now come to an end. Industrial production in Q4 1981 ½ per cent up on Q3 and some 2 per cent up on H1. Budget forecast suggests there may be 3 per cent increase in manufacturing output in 1982 as a whole. March CBI enquiry and FT opinion survey encouraging (see B3).

3. Company financial position?

[Non-oil industrial and commercial companies (ICC's) gross trading profits (net of stock appreciation) rose by over a quarter between 1H and 2H 1981, but from a very low base - ICC's real rate of return just 2½ per cent in 1981. ICC's finances showed some weakening in 4Q reflecting slowdown in destocking and unwinding of civil service dispute, but finances better in 1981 as a whole -

£bn

	1979	1980	1981 Year	H1	H2
Net borrowing requirement (+)/repayments (-)	+6.1	+5.7	+4.4	-1.2	+5.6
Financial surplus (+)/deficit (-)	-2.7	- 1½	+1.2	+1.5	-0.3]

Increase in profits (albeit from low level) encouraging. Some apparent deterioration in financial position reflects slowdown in rate of destocking, and effects of unwinding of civil service dispute (which delayed companies' tax payments), but companies' finances much healthier in 1981 than in two previous years.

4. Rate of return still too low?

[Real pre-tax rate of return of ICCs was 2½ per cent in 1981 - half the previous lowest figure in 1975.]

Yes, but Government can only help in limited ways. Fundamental improvement in ICC's profits and real rates of return depend on improved performance by companies, both management and employees. Much encouraged by recent productivity gains and trend towards moderate pay settlements.

5. High interest rates damaging for industry and investment?

[Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.]

Budget measures have eased pressure on interest rates, and the recent ½ per cent fall in the banks' base rates is encouraging. But Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Continuing relatively high level of interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFS. (See brief J).

6. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken so far to over ninety. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme this year (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

7. Response to Loan Guarantee Scheme?

Scheme operating successfully. We have already issued more than 3,350 guarantees - about half to new businesses. Total lending under scheme is just under £114 million. Budget provided for the lending ceiling - in year to May 1982 - to be raised from £100 million to £150 million. Further £150 million will be made available in following year. Three more banks admitted to scheme in April making total of thirty financial institutions now participating.

8 Progress with setting up Enterprise Zones?

Excellent progress being made. All of eleven zones now in operation, following designation of final zone - Isle of Dogs - in April.

9. Response from private sector?

Response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

R NATIONALISED INDUSTRIES

GOVERNMENT RELATIONS WITH NATIONALISED INDUSTRIES

[Industry Secretary announced 15 March that Government is to change its dealings with nationalised industries by agreeing objectives with each, putting more emphasis on efficiency by increasing Monopolies and Mergers Commission references and through board structures, and by strengthening business expertise in Whitehall.]

1. Whitehall making a take-over bid for the industries?

Monitoring not same as interference in management. Crucial for officials and Ministers to be informed about the industries' progress and about any problems that arise; no intention to interfere with proper role of management within the industries.

EXTERNAL FINANCING LIMITS

2. EFLs for 1982-83 and future years?

Nationalised industries' total external finance increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes), £1.7 billion in 1983-84, £1.2 billion in 1984-85 - a total of over £4 billion over the three years of the Survey. Government has given full recognition to problems faced by the industries in a period of recession. Increase in 1982-83 was roughly half what the industries bid for.

3. Unreasonable to reduce EFLs following NIS cut?

Reduction in the National Insurance Surcharge was designed to benefit private sector; not the intention that public sector should gain from it. Amendments to EFLs announced 7 April are offsets to the addition to the industries' internal resources that would have followed the NIS cut. No industries will be worse off than previously, and their plans should be unchanged.

4. Pay assumptions?

Government has not set pay or any other assumptions for the industries. Moderate pay settlements - and restraint of current costs generally - essential if investment programmes to be maintained and prices to consumers kept down.

INVESTMENT

5. How robust are the forecasts of nationalised industry demand/contributions to public expenditure, given the recent track record?

Plans published in PEWP at Budget time considerably less optimistic than those published last year.In particular, in increasing substantially the external finance available to the industries in each year of the Survey, Government recognised effect of lower demand on the industries' internal resources - now expected to be well below the levels in last year's White Paper (by about £2 billion in each of the years 1982-83 and 1983-84). The industries' external financing needs still expected to decline over Survey period, but from higher base and at more gradual rate than forecast last year.

6. Investment plans unlikely to be attained?

No Government can unconditionally guarantee a level of investment by the nationalised industries. Approved levels set out in White Paper are consistent with the industries' agreed external financing requirements, on the basis of their internal resource forecasts. But perfectly possible that plans might need to be revised, for example if the industries fail to restrain their current costs, including pay.

7. But shortfall in capital spending 1981-82?
[Figures in FSBR imply shortfall of £¾ billion.]

Not easy to establish firm reasons after the event. Such evidence as we have suggests a mixture of reasons. Most important has been cut in investment in response to changed circumstances such as lower market demand. These cuts have been extraneous and have not borne any direct relationship to EFL pressures. Other cuts have been for wholly beneficial reasons, such as lower than expected inflation and cost savings.

8. Take nationalised industry investment out of PSBR?

Real problem of pressure on resources cannot be solved by changing statistical definitions. Since nationalised industries are part of public sector, their borrowing - for whatever purpose - must by definition form part of public sector borrowing requirement.

9. Private finance for NI investment?

[NEDC Working Party's study of nationalised industry investment was discussed at Council's 5 October meeting: agreed there should be review of progress to be completed by June 1982.]

We have indicated willingness to consider new financing proposals. Direct market finance can only be justified if there is genuine element of performance-related risk for investors, in order to improve incentives to management efficiency, and if new forms of saving are tapped, to avoid adverse monetary consequences. Market financing does not of itself lessen burden on financial markets.

10. Does Government propose to sell shares in BT?

Recent press reports are speculative. As the Chancellor announced in Budget statement, detailed work is proceeding on 'Buzby bond'. Government continues to examine ways in which market pressures could be brought to bear on nationalised industries, including BT.

11. Finance more nationalised industry investment by cutting current spending?

Yes. As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

NATIONALISED INDUSTRY PAY AND PRICES

12. Nationalised industries' prices

[March figures: RPI up 11.4 per cent, NI component up 11.5 per cent.]

Nationalised industries' price rises have been due in part to ending of previous Government's policy of artificial and distortionary price restraint between 1974 and 1980. But since middle of 1980-81, gap between NI price increases and RPI has narrowed. Artificial price restraint would result in unacceptable increased burden on taxpayer and distortion of market forces.

[CAUTION: gap between NI and 'all items' RPI could widen again in near future. Factors include LT fare increases in spring, winter electricity discount scheme ending, dropping out of RPI of last year's double revalorisation of excise duties.]

PRIVATISATION

13. What further sales expected?

Special sales of assets in 1982-83 forecast at around £700 million and around £600 million in each of the later years. These figures well above those in last White Paper. This reflects primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - to be made possible by Oil and Gas (Enterprise) Bill currently before the House.

14. <u>Net figure for special asset sales this year</u>?

[Public Expenditure White Paper showed net sales of only £50 million in 1981-82; latest estimate included in FSBR is -£100 million - ie £100 million <u>net</u> purchases.]

Low net figure is result of decision not to proceed with further programme of advance oil sales in weak market. Gross figure expected to be in line with £500 million target included in last White Paper; will include proceeds from Cable & Wireless, sale of Amersham International Limited and National Freight Company Limited, sale of Government's shareholding in British Sugar Corporation, and further sales of motorway service areas long leases.

15. <u>Government simply selling valuable national assets to achieve PSBR target</u>?

Of course the cash is welcome, but benefits run wider than that. Not only will any future borrowing by these undertakings be outside the PSBR, so reducing burden on taxpayers, but the organisations concerned will be made more responsive to market forces and thus have greater incentives to improve efficiency.

16. <u>Government running into heavy weather over sale of Wytch Farm</u>?

The British Gas Corporation is proceeding with arrangements for sale of the Government's interest in Wytch Farm. It is too early to say when the sale will take place.

17. <u>Government has sold assets too cheap? (PAC criticisms)</u>?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices where shares first traded. PAC report published 28 April criticised handling of British Aerospace sale.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially when company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares. Hon members will have to wait for formal Treasury Minute responding to PAC report.

S NORTH SEA AND UK ECONOMY

1. In view of recent falls in price of oil, why did HMG not reduce tax burden on North Sea oil producers?

[Budget tax changes included abolition of Special Petroleum Duty, increase in Petroleum Revenue Tax rate from 70 per cent to 75 per cent, and new system for advance payments of PRT (all from 1 January 1983), plus smoothing of PRT payments from July 1983 (this improves HMG's cash flow at companies' expense). Changes reduce the marginal rate of tax (from 90.3 to 89.5 per cent); involve slight fall in Government 'take' (no change 1982-83, costs £70 million 1983-84).]

Recognise need for tax structure robust to both falling and rising prices. Detailed study showed us that under new structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that new tax structure will provide more secure and stable regime.

2. Onerous tax system damaging future field developments?

[Shell/ESSO announcement plans for Tern shelved partly because of tax system].

Other adverse factors - falling oil prices; high development costs - much more important. No evidence that tax system alone is inhibiting future development.

3. Government has missed opportunity to simplify North Sea fiscal regime?

The oil industry has made it clear that it would not welcome a structural upheaval. Would create serious uncertainty and major transitional problems.

4. Impact of falling oil prices on Government revenues and Government strategy?

Other things being equal, lower oil prices will reduce Government revenues from the North Sea. Treasury has estimated that each $1 off the price directly reduces revenue, other things being equal, by £250 million in first year and £350 million in full year. Chancellor warned in his Budget statement he could not rule out possibility of having to take action to correct the fiscal balance if there were to be a marked and prolonged fall in oil prices. But falling world oil prices are good for the world economy. We will benefit from that - not only from impact on activity, but also lower oil prices will help in reducing inflation.

5. Implications of OPEC production limitation agreement for North Sea oil prices?

Remains to be seen whether the agreement will hold, and whether world oil prices will harden as a result.

5. Benefits of North Sea should be used to strengthen the economy?

[FSBR projections (in money of the day) of Government revenues from North Sea: £6.4 billion in 1981-82, £6.2 billion in 1982-83, £6.1 billion in 1983-84, and £8.0 billion in 1984-85. Lower than last year's projections, principally because of downward revision to oil price expectations. Projections already incorporate fall to $31 a barrel for Forties oil. Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise before 1985.]

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

7. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

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

North Sea revenues are already committed. Setting up a special Fund would make no difference. More money would not magically become available. So the money for this Fund would have to come from somewhere else. This would mean higher taxes or lower public expenditure, if public sector borrowing is not to rise. If borrowing did rise, then so would interest rates. Not obvious that net effect would be good for investment.

9. Are we really any better off for our North Sea Oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared the fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil is costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for the possession of oil to require a contraction in our industrial base.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Government will have no choice but to reverse policies now unemployment has risen to post-war record levels in many Western countries?

Unadjusted unemployment exceeded 10 million in USA and 1 million in Canada in January. It exceeded 2 million in Italy in September, 2 million in France in October, and 1.9 million in Germany in February. Highest ever unemployment levels in Canada, France, Italy and UK and highest in USA and Germany since the War.]

No indication of a widespread departure from consensus achieved last year (eg Ottawa Summit, IMF Interim Committee) about need for prudent fiscal and monetary policies to bring down inflation.

2. Anti-inflation policies not working?

[Year on year consumer price inflation in major countries fell to 8.5 per cent in February. Underlying rates falling in US. OECD and IMF expect some decline in 1982.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980: some decline expected 1982.

3. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

4. Other countries giving priority to reducing unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

5. Other governments not following such stern policies as UK?

[Most major countries (US, Japan, Germany, Italy, Netherlands, Belgium, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Belgian government has used its special powers to freeze prices temporarily and severely curtail wage increases for rest of 1982.]

Most governments presevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

6. UK is alone in Europe. Even Germany announced investment/employment scheme?

UK far from alone. Almost all European governments working to curb public spending, budget deficits and monetary growth. Netherlands has just agreed to measures which will reduce PSBR by about 0.9 per cent of GDP below what it otherwise would be. French government has set limit on its budget deficit for 1983 of 3 per cent of GDP. German government plans to reduce its borrowing in 1982 Budget even in nominal terms by almost 30 per cent. Unlikely investment/employment scheme will entail any significant increase in borrowing - increase in VAT (by 1 per cent to 14 per cent) part of the package from 1 July next year. Impact on employment remains to be seen.

7. Prospects for UK economy worse than for other countries?

No. Treasury and most independent forecasters expect UK growth this year of about 1½ per cent rising to an annual rate of 2 per cent by early next year. This is very closely in line with the OECD's forecast for OECD Europe. Unemployment is expected to rise in all major countries except Japan. UK inflation (GNP deflators) likely to be around the OECD average and below that in France, Italy and Canada.

8. Prospects for US economy?

[In March US industrial production fell 0.8 per cent, to 8.3 per cent below July's peak; February's rise was shown to be a statistical blip on the chart and on 17 April Treasury Secretary Regan pronounced the economy 'dead in the water'. Seasonally adjusted unemployment is now 9 per cent of the labour force. Inflation fell for the 5th consecutive month to 7.6 per cent in February.]

Continued decline in inflation is good news; wage settlements in which unions have given job security priority over wage increases are contributing impressively to this decline.

9. US Budget compromise?

[Discussions continue: extra revenue proposals include 4 per cent supertax on incomes over £22,000, higher taxes on tobacco, liquor and oil imports; unspecified cuts in planned defence and Social Security spending also mooted.]

Firm monetary policy needs to be backed up by tighter fiscal policy. Hope that Congress and Administration soon reach an agreement that will reduce federal deficits and uncertainty in the financial markets. High US interest rates in no-one's interest.

10. Recent international interest rate developments?

True that US interest rates rose earlier this year. But prime rates are well below their peak of 21½ per cent last summer (currently 16½ per cent)

11. Prospects for international interest rates?

Always difficult to force interest rates with certainty, but firm and balanced policies should over a period bring lasting reduction in both inflation and interest rates.

12. OECD forecast leaked?

[Some OECD forecasts on the world economy have been leaked to The Times which published them on 23 April, with one misprint.]

Can neither confirm nor deny accuracy of press report of unpublished forecast by OECD. OECD's twice-yearly Economic Outlook still being prepared; not due to be published until July.

/2

AIDE MEMOIRE ON THE UK ECONOMY 30 April 1982

PRESENT SITUATION

Clearly a range of outside forecasts; from ITEM and CEPG the more pessimistic to Liverpool more optimistic. Most major post-Budget assessments (LBS, NIESR, St James, P&D, St J) judge impact of Budget and falling oil prices favourable. Output by those groups forecast to grow about 1½ per cent in 1982 (cf FSBR's 1½ per cent), inflation to fall to single figures by end 1982 (cf FSBR's 9 per cent in 4Q 1982); very much in line with FSBR. CEPG broadly in line on inflation prospects, but see little prospect of any growth in output in 1982 or 1982. All groups expect continued rise in unemployment (UK adult sa) during 1982 to around 3 million. Forecasts for 1983 vary, from some groups expecting further rise (CEPG, NIESR, ITEM) to others (P&D, Simon and Coates) expecting some slight decline (roughly 50,000-100,000) and Liverpool expecting fall of 400,000.

GDP output estimate rose in both Q3 and Q4 1981. Level in Q4 some 1 per cent above Q2. Recent months' industrial output figures affected by bad weather, car and rail strikes. Nevertheless, Q4 1981 manufacturing output some 2-3 per cent above low point in Q1 1981.

Consumers' expenditure was unchanged in Q1 1982: continuing the flat trend of the last 2-3 years. Retail sales in Q1 1982 rose 1 per cent returning to the level of a year ago. The volume of visible exports in the last few months of 1981 were high compared with the level earlier in that year but there was a sharp drop in this volatile series in January 1982. Latest evidence indicate that there has been a significant rise in the volume of visible imports since the middle of 1981. DI investment intentions survey conducted in October/November suggests volume of investment, by manufacturing, distributive and service industries (excluding shipping) will rise by about 2 per cent in 1982 following a fall of about 5 per cent in 1981. A large rise is tentatively expected in 1983. Investment by manufacturing (including leasing) is expected to rise during 1982, but for the year as a whole it is likely to be 1 per cent lower than 1981. An appreciable rise is expected in 1983. Manufacturers', wholesalers' and retail stocks dropped by £25 million (at 1975 prices) in Q4 1981 the smallest quarterly fall in the last two years of continuous destocking.

Unemployment (UK, seasonally adjusted excl, school-leavers) was 2,850,400 (11.9 per cent) at April count, up 28,000 on March. Vacancies were 109,600 in April.

Wholesale input prices (fuel and materials) fell 2 per cent in March causing the year-on-year increase to dip to 8 per cent. Wholesale output prices rose ½ per cent in March but fell to 9½ per cent above a year ago. Year on year RPI increase fell to 10.4 per cent in March. Year-on-year increase in average earnings was 11.3 per cent in February. RPDI was flat in

the last three quarters of 1981; it fell 2 per cent between 1980 and 1981 after rising 17 per cent between 1977 and 1980. The savings ratio fell 0.7 points to 13.1 per cent in Q4 1981.

PSBR £8.6 billion and CGBR (unadjusted) £7.6 billion in the financial year 1981-82 but both distorted by the effects of the civil service dispute.

In banking March Sterling M3 and PSL1 both rose 0.2 per cent while PSL2 rose 0.6 per cent and M1 fell by 0.7 per cent.

Visible trade has showed a surplus of £0.5 billion on the 5 months from September 1981. Current account surplus over same period of £2 billion and likely surplus in 1981 as a whole £8 billion. UK official reserves following revaluation were $19.0 billion at end-March. At the close on 29 April the sterling exchange rate was $1.7955 while the effective rate was 89.7.

COVERING PERSONAL AND SECRET

2

SECRETARY OF STATE FOR EMPLOYMENT

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26 April 1982

Dear Mike

PRIME MINISTER'S UNEMPLOYMENT BRIEF

.. I attach this month's unemployment brief for the Prime Minister.

Could I again ask you to return last month's folder in due course?

Yours ever

Ros McCarthy-Ward

ROSALIND McCARTHY-WARD
Private Secretary

Econ Pol
Strategy.

PPS/CHANCELLOR

file no TEB/CA/01

copied to:

Mr Salveson (for transmission to No.10)
PS/CST
PS/FST
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PS/MST(C)
PS/MST(R)
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PS/Foreign Secretary
PS/Secretary of State for Education and Science
PS/Lord President of the Council
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PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 19 April, are sidelined.

M M Deyes

M M DEYES

RA

R I G ALLEN

26 April 1982

EB Division
H M Treasury
01-233-3364

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation and promotion of enterprise and initiative. Reduction of inflation requires maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Falkland Islands: Cost/Financing of operation?

No cash ceiling on the cost of the operation; needs of task force must and will come first. When the cost is known we shall decide how to deal with it. But cost can and will be met in ways consistent with Government's economic strategy. [IF PRESSED: Not all of cost will be additional. At this stage, extra cost represents very small proportion of (over £14 billion) Defence Budget. No cash or budgetary problem immediately in prospect. Also complete nonsense to suggest that ability to respond to Falklands crisis has been weakened by Government's so-called cuts in defence spending. Government has actually increased defence spending by over 85 per cent in cash terms and about 11 per cent in real terms since 1978-79.]

3. Financial markets right to be worried by Falklands crisis?

No. Of course, markets are preoccupied with the dispute but it needs to be kept in perspective. UK is basically in a strong financial position: inflation is coming down; interest rates were falling before the crisis; balance of payments remains healthy; output is recovering. Disturbance due to Falklands dispute small in relation to overall macro-economic picture. And the basic strengths in the economy have not changed (see Section J for latest interest rate position).

4. Contribution made by 9 March Budget to economic strategy?

Budget continues Government's medium-term strategy for economy. Designed to make further progress on inflation and restore base for economic growth, improved output and increased employment. Tax cuts and other measures designed to help both business and individuals, within responsible fiscal framework.

5. Reflationary/deflationary/effect of Budget on demand?

Oversimple question. Wrong to talk about what government is 'putting into' or 'taking out' of economy. Ignores links between fiscal and monetary policy and their effects through financial behaviour (interest rates and exchange rate), on economy. Budget's overall effect is to support sustainable recovery.

6. Effects of Budget and December announcements together?

[December announcement provided for £5 billion increase in public expenditure plans for 1982-83 and increased NIC rates yielding £1 billion extra revenue. But total Government revenue in 1982-83 now expected to be some £3½ billion higher than at time of 1981 Budget. Taking account of all these changes, pre-Budget PSBR for 1982-83 about £8¾ billion; post-Budget forecast about £9½ billion.]

No simple answer to this question. So much depends on base one starts from, and what counts as a policy change. But overall effect is reflected in a PSBR for 1982-83 only a little higher than planned in March 1981.

7. Not enough help for industry?

Main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates. In addition, specific Budget measures aimed at industry and business will cost about £1 billion in 1982-83. Signs of recovery in profits and financial position of industrial and commercial companies. (See also Section P).

8. Does more for industry than for people?

Help to industry is help to people. Higher allowances and thresholds more than compensate for inflation in last year and make up some of ground lost last year. Many other smaller changes (eg on charities) will help particular groups of people.

9. Another Budget pushing up prices?

No. Changes in excise duties slightly less than required for full revalorisation. 12-monthly inflation rate now 10½ per cent (March figure published 23 April) - down from 11 per cent in February. Single figure inflation rate expected well before end of year.

10. Effect of Budget on personal incomes, incentives etc?

See Section D.

11. PSBR for 1981-82 only £8½ billion. Deliberately under-stated in 1982-83 FSBR?

See Section H.

12. Does this imply too tight fiscal policy?

Had PSBR been higher, so too would have interest rates. Important question now is what level of PSBR for 1982-83 is acceptable in terms of interest rates.

13. Monetarism dead?

'Monetarism' a much over-used, misused and misunderstood word. Medium-term framework provides essential reference point for policy. Nonsense to suggest MTFS is being slavishly and dogmatically adhered to. Only right to take account of changing circumstances: that is what we have done. But such adjustments do not reflect any weakening in resolve to tackle inflation. Judged by results, policy is succeeding. Inflation has been reduced and is now coming down again.

14. Outlook for unemployment?

[NB. April figures to be published Tuesday 27 April.]

Budget forecast shows continuation of recovery; not the practice to publish estimates of the overall effects of the Budget, or its individual measures, on employment or output. (See also Section C)

15. Recovery over?

[February industrial production figures, published 15 April, show only relatively modest recovery from strikes/severe weather affecting December/January levels; industrial production still at broadly same level as last autumn]

[NB. No. Underlying levels of output above that of last Spring. Most forecasters, along with FSBR, expect continuation of recovery this year; and some see growth accelerating in 1983 (see also Section B).

16. Not keeping to commitments to reduce expenditure?

Increases announced in Budget offset by reductions leaving totals still around £115 billion. FSBR shows declining ratio to GDP in future years. (See also Section E).

17. Armstrong/unified Budget?

[Reports in Press of TCSC draft of their report]

Proposals have wide implications. Need careful consideration. Government does take account of tax and expenditure when taking decisions on each. Await TCSC report with interest.

BULL POINTS

As at 26.4.82

(i) Activity recovered by 1 per cent during 2H 1981. Most recent major independent forecasts see the prospect of recovery in 1982.

(ii) Earnings and settlements. Increases halved in 1980-81 pay round. Public sector in line. There is a good deal of evidence that average settlements in private sector are running lower than in the 1980-81 round. [CBI pay data bank for manufacturing settlements suggests average is now around 7 per cent compared with 9 per cent in previous round.]

(iii) Manufacturing productivity. Output per head rose 10 per cent during 1981. Output per head and output per person 3½ and 6½ per cent higher than previous peak in 1H 1979.

(iv) Unit labour costs: Pay moderation and higher productivity has meant dramatically low increase in manufacturers unit wage costs over last year - just 3½ per cent in 3 months to January 1982 on a year earlier. Recent rate of increase below the average of our major competitors and comparable to that of Germany and Japan.

(v) Competitiveness. Improved by over 10 per cent during 1981, reflecting pay moderation combined with exchange rate fall.

(vi) Profits: Industrial and commercial companies gross trading profits (excluding N.Sea and net of stock appreciation) rose strongly during 1981, up over 25 per cent between 1H and 2H 1981.

(vii) Exports have held up better than many feared (but low January figures have undermined earlier favourable comparison - non oil exports Sept '81 to Jan '82 up only 1 per cent in 1980). Engineering export orders up 17 per cent in 1981 on 2H 1980 to reach their highest level.

(vii) Unemployment. Rate of increase in unemployment has slowed further to just 1/4 that of a year earlier. Vacancies improved since mid 1981. Short-time working in manufacturing reduced by over ¾'s since January 1981 and overtime working has increased.

(ix) Special employment measures. Total provision on Job Release Scheme, Temporary Short-Time Working Compensation and Community Enterprise Programme in 1982-83 now planned to reach over £520 million, with additional £61 million for young worker scheme (starting January 1982). Spending on Youth Opportunities Programme to rise to £700 million in 1982-83. 280,000 unemployed school-leavers last year found places on YOP by Christmas.

(x) Training. Over next 3 years £4 million to be provided to bring training schemes up to date. New Youth Training Scheme for school leavers to be introduced September 1983 represents major step towards comprehensive provision for young people.

(xi) Industrial relations. Number of strikes in 1980 and 1981 less than in any year since 1941 and number of working days lost only a third of average of last ten years.

(xii) Inflation. Increase in RPI more than halved since peak (21.9 per cent) in Spring 1980. 12 monthly RPI increase in March of 10.4 per cent. Wholesale price inflation in single figures - 9½ per cent in year to March.

(xiii) Share Ownership Schemes: Number of schemes has increased from 30 in May 1979 to over 400. Number of employees covered roughly doubled between first and second years in office. Profit sharing schemes alone now cover some 270 thousand employees.

(xiv) Examples of export successes reported in the Press include: £5 million plus order secured by Manchester firm (NEI-APE Ltd) for engines to power five patrol boats being built for Hong Kong Government via Scottish shipyard (Hall Russel and Co); computer-system for handling chemical structures bought by two Japanese pharmaceutical companies (Fraser Williams (Scientific Systems Ltd)).

(xvii) Overseas investment in UK: US direct investment in Britain amounted to stock of over $14 billion in 1980. Nearly 60 per cent of all US outward non-oil direct investment now takes place in EC - over half of that in UK. Half of all Japanese investment in the EC also comes to Britain.

(xviii) Overseas debt repayments. Official external debt reduced from over $13.3 billion at end-1981.

Innovation. Total of industrial robots in use in UK reached 713 last year; expected to pass 1000 this summer, UK is fifth in World league table of robot users.

Economic Briefing Division, HM Treasury, 01-233 3819/5809

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent position?

All three GDP measures were higher in real terms in Q4 1981 then had been earlier in year. GDP (output) in Q4 was nearly 1 per cent up on Q2 - the earlier low point.
[IF PRESSED on apparent weakening of recovery (based on November/December/January industrial production) - see 2 below.

2. Recent industrial and manufacturing production figures show resumed decline?

[Latest industrial and manufacturing production figures show upward revision to January's index removing decline shown last month and some bounceback in February's index to level of last November.].

Latest figures (including revisions) show that as expected February saw some recovery from weather and strike effected levels at turn of year; and that effect of these in January was less than earlier presumed. CSO's press notice clearly states that underlying level of output above low point of spring of last year. Industrial and manufacturing output in 4Q 1981 some 2-3 per cent above low point earlier in year.

3. Business opinion

March business opinion surveys show encouraging improvement. CBI's monthly enquiry saw further improvement in order books, and rise (to 4 per cent) in net balance of firms expecting to increase output in next four months. FT business opinion survey corroborates this, and shows increased business optimism.

4. Other evidence of improvement in economy?

See Bull Points (following Section A).

5. Government assessment of prospects

[FSBR forecast (9 March) assesses recovery to have begun. Main points are:

	per cent increase on year earlier	
	1982	1983 H1
GDP	1½	2
Manufacturing output	3	2
Consumers expenditure	½	½
Investment (private sector and public corporation)	4½	5
Exports	3½	3

Forecast expects some stockbuilding in 1982, Government expenditure flat.]

FSBR forecast sees prospect of some recovery continuing into 1983. (Last two Government assessments of economy were broadly correct). Healthy rise in private sector investment and exports. Inflation well into single figures (7½ per cent) by mid 1983. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

6. Outside forecasts

[GDP profile in major post-Budget assessments:

	NIESR (March)	LBS (March)	St James (March)	Phillips &Drew (April)	FSBR (March)
Per cent change 1982 on 1981	+1½	+1½	+1¼	+1¾	+1½]

Nearly all see prospect of continued recovery in 1982 in line with FSBR, (as always, a range, with Cambridge forecasts being the more pessimistic) and see inflation at 8-9½ per cent by Q4 1982 - also in line with FSBR. [See also C4 (unemployment), K4 (inflation) and L10 (balance of payments).]

7. Cambridge Economic Policy Review gloomy forecast?

[Document published 26 April gives base projection and assessment of results alternative policies.]

Base projection is, as usual, somewhat out of line with FSBR and other forecasts (more pessimistic on growth and more optimistic on inflation; particularly gloomy on export prospects). Analysis of alternative policies supports view that even substantial reflation would produce few jobs - £30 billion over 3 years estimated to reduce unemployment by only 300,000 over 2 years.

C LABOUR MARKET

1. Recent unemployment figures?

[New unemployment statistics for April to be published Tuesday, 27 April. Separate briefing will be supplied to No.10].

2. Vacancy figures disappointing?

[New vacancy statistics for April to be published Tuesday, 27 April. Separate briefing will be supplied to No.10.]

3. Effect of Budget on unemployment?

Budget contributes to Government strategy of fostering conditions for sustainable growth. Help to business will lay foundation for more real jobs. Employment will benefit from some further improvement in activity. Proposed new non-profit-making scheme will enable local authorities and voluntary sponsors to provide many new jobs. (MSC to advise what possible: for illustration, Government prepared finance 100,000 at net additional Exchequer cost of £150 million).

4. Unemployment expected to continue rising rapidly?

[Outside forecasters see continued rise in registered unemployment during 1982 reaching about 3 million (UK adults) in Q4. Opinion divided for 1983, some pre-Budget forecasts (CEPG, Cambridge Econometrics, ITEM, NIESR) see rise continuing but at a slower rate, others broadly flat (LBS, St James); only Liverpool foresee a fall (400,000). Some post-Budget forecasts (P&D, S & Coats) expect slight (roughly 50-100,000) fall in 1983.]

Unemployment forecasts uncertain; independent forecasters encompass differing views for 1983 - several projecting stabilisation, some [a slight] decline. Rise in unemployment drastically reduced since end 1980. Clear evidence of further slowing down this year - Q1 1982 rise just 1/5 that in Q4 1980. Vacancies, short time and overtime all improved last year. Employment situation will benefit from some further recovery in activity this year.

5. Government forecasts for unemployment

[1982 PEWP uses working assumption of an average level of 2.9 million unemployed in Great Britain (excluding school leavers) in 1982-83 and rest of survey period. School leavers, adult students, temporarily stopped and Northern Ireland imply UK total unemployed of 3.2 million in 1982-83.]

Very difficult to forecast. Following well-established precedent of previous administrations is not publishing. Public Expenditure White Paper figures are planning assumptions not forecasts.

IF PRESSED that PEWP figures show Government planning sustained higher level of unemployment: No. Maintaining constant figure for the Survey period is conventional assumption adopted by previous Administration. PEWP figures consistent with the prospect of some fall in total unemployment before the end of 1982-83. They do not however necessarily imply this. If things go well - eg lower pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.

6. Employment continuing to fall?

[Total employment declined 1.9 million or 8 per cent in 2 years to Sept 1981. Provisional Q4 figures indicate decline of over 200,000 compared with 150,000 in Q3 and 300,000 per quarter in H1 1981.]

Decline in H2 1981 almost half that in H1. Other labour market indicators improving (see C1, 2 and 4 above).

7. Unemployment higher than in other countries?

[On standardised definitions in 3Q 1981 UK employment was 11½ per cent compared with 6¾ per cent OECD rate; a UK doubling compared with an OECD rise of a third since 1979.]

Whole world affected by rising unemployment. In our case we have additional self inflicted wounds of high pay awards and low productivity. Unemployment now rising very fast in some countries eg Germany.

8. Higher Exchequer costs of unemployment? Recent Treasury estimates suppressed?

No 'right' figure. Estimates depend critically on assumptions used, the causes of unemployment and items of 'cost' covered. [IF PRESSED: Estimates have been made of cost of additional registered unemployment (eg for 1980-81 in February 1981 EPR). Attempt made to update to 1981-82 - range of figures has been calculated. But doubts expressed about assumptions used. Work, therefore, continues. No decision whether to publish.] Cannot gross up such figures to produce total cost (in terms of lost taxes and extra benefits) of all the unemployed. Meaningless concept. Implies comparison with an economy with zero unemployment. Can say total expenditure on unemployment and supplementary benefits paid to the unemployed estimated at £4.3 billion in 1981-82 and £5 billion in 1982-83.

9. What is Government doing to provide more jobs?

Illusion to think Government can switch employment off and on like a tap. Government pursuing sensible fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless Government expanding schemes to meet special difficulties and improve training - eg plan to spend £1½ billion in cash on 1982-83 (40 per cent more than in 1981-82) on special employment and training measures; new Youth Training Scheme costing £1 billion a year from 1983-84; and new measure announced in Budget. (See C3).

D TAXATION

1. Burden of taxation

[Total taxation (i.e including for example income tax, indirect taxes, corporation tax, rates and NIC) in 1978-79 was 34½ per cent of GDP (at market prices), 36 per cent in 1979-80, 37½ per cent 1980-81. It is forecast to be 40 per cent in 1981-82 and 39½ per cent in 1982-83.]

This has inevitably increased during a time when the recession has been adding to public spending. Changes proposed in Budget will reduce total burden next year compared with 1981-82. [NB: Not true of burden on persons.]

2. Burden of tax has risen for most households since 1978-79?

[Comparisons given in Parliamentary Answers to Mr Straw 3 December, 17 February and 18 March col W199.]

Slow growth of output and difficulty of restraining public expenditure have inevitably meant higher tax burden. But real personal income after direct taxes still higher than under last Government. And more honest to raise taxes to finance necessary higher expenditure than to increase borrowing, with the increased interest rates and inflation that would bring.

3. Burden has fallen for the rich?

Only because of abolition of absurdly high marginal rates and raising of thresholds in 1979 Budget.

4. Burden has risen most for the poor?

Proportion of income paid in income tax and NICs will fall next year (82-3) for lowest paid taxpayers. And low paid with children entitled to benefits such as FIS.

5. Personal tax burden increased by the recent Budget - when NICs taken into account?

[Full explanation given in Parliamentary Answer 11 March OA col 955].

The real increase in personal allowances and tax thresholds will reduce income tax as a percentage of income at all levels of incomes. [IF PRESSED: In immediate cash terms, increases in personal allowances etc will compensate for NIC increase for majority of taxpayers. Taking into account increased earnings in 1982-83 (for example using the Government Actuary's 7½ per cent assumption) percentage of income paid in income tax plus NIC will rise for most people, but will fall for the lowest paid (below about ½ average earnings (married) and below about 1/3 average earnings (single).] Those over pension age who are taxpayers will benefit from income tax changes and will be unaffected by NIC rise, and, of course, State pensions are being uprated from November .

6. No improvement in incentives?

There will be 1.2 million fewer taxpayers than if allowances had remained at 1981-82 levels, and ½ million fewer higher rate taxpayers. For the substantial number taken out of tax or with reduced marginal rates, incentives will improve.

7. No help on poverty trap?

Numbers in Poverty Trap should not be exaggerated. Increases in income tax allowances have a beneficial impact. [IF PRESSED: overall, small increase in numbers in poverty trap (10,000) as result of FIS uprating. But this helps low paid and generally makes employment more attractive than unemployment.] Whole question of interaction between income tax and social security benefits is being examined by the TCSC Sub-committee (chaired by Mr Meacher). This is a complex area; the sub-committee is a more suitable forum for discussion.

8. Reduction in NIS not enough?

Cut welcomed by CBI and industry generally. Provides substantial help on business costs. 1 per cent reduction maximum possible without risks for PSBR: outright abolition too costly. And other measures to help business directly - energy, construction, innovation and enterprise packages plus helpful - and welcomed - improvements in capital tax regime (see also Section P).

9. Excise duties increases inflationary/harmful to industries

Increases in excise duties as a whole slightly less than broadly compensate for past year's inflation. Variations between duties take account of industrial considerations e.g supplementary increase last July on tobacco/Scotch whisky industry/help for industry by smaller increases on e.g derv - mainly used by industry.

10. Government take from North Sea oil too high?

See S1.

E PUBLIC EXPENDITURE AND FINANCE

[Public Expenditure White Paper (Cmnd 8494) published 9 March. Gives planning totals of £115.2 billion in 1982-83, £121.1 in 1983-84 and £128.4 in 1984-85. About £5 billion higher than last White Paper in 1982-83 and £7 billion in 1983-84. Net effect of changes announced in Budget is to reduce totals to £114.9 billion, £120.4 billion and £127.6 billion].

1. Public expenditure too high?

Spending in 1982-83 planned to be about £5 billion (4½ per cent) lower than intended by last Government even if higher than planned when this Government first took office. Decisions to increase spending represent flexible but prudent response to changed circumstances e.g additional spending to help young unemployed. Drive to improve management in public sector and reduce administration expenses continues.

2. Ratio of public spending to GDP is getting back to peak levels of mid 1970's?

Ratios in 1980-81 (43½ per cent) and 1981-82 (45 per cent forecast) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 mainly reflects higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years: assumptions in MTFS would mean figures of 44½ per cent in 1982-83, 42½ per cent in 1983-84 and 41 per cent in 1984-85. Reflects assumed GDP growth and curbing of public expenditure.

3. Cuts in defence spending have weakened our ability to respond to Falklands crisis?

No. We have not cut defence spending since 1978-79. We have increased it by over 85 per cent in cash terms - a real increase of about 11 per cent - to over £14 billion. We are spending more on conventional naval forces in real terms than was spent in year before we came to office. When expenditure on modernising strategic deterrent is at its peak we will still be spending more on conventional Navy than in 1978-79.

4. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term, and would soon lead to more inflation and higher interest rates and inflation. We are responding, within limits of prudence, to needs of current circumstances.

5. Real terms comparisons

No volume equivalents of cash plans. But cash increase in plans between years is 9 per cent in 1982-83, 5 per cent in 1983-84 and 6 per cent in 1984-85 (and projection of GDP deflator in MTFS is rather lower than this in 1982-83, rather higher in 1983-84 and about same in 1984-85). So in cost terms [i.e cash inflated/deflated by general movement in prices] there is an increase in 1982-83, a decrease in 1983-84 and a small decrease in 1984-85.

6. Plans unrealistic, given e.g overspending in 1981-82/future rates of inflation?

Total spending in 1981-82 expected to be only a little [NOT FOR USE: 0.4 per cent] higher than planned a year ago. Major reason for overspending is present level of spending by local authorities; this has been taken into account in plans. Realism, particularly in respect of local authorities and nationalised industries, is one reason why plans for future years are higher than in previous White Paper. Large Contingency Reserves due to greater uncertainty in later years and designed to give realistic planning totals.

7. Higher inflation than allowed for in PEWP may raise public spending?

True that inflation assumption in FSBR slightly higher than in PEWP, but:

- for 1982-83 confident that planning total including Contingency Reserve will hold;
- for later years inflation assumption in FSBR a little higher than cost factors used in building up cash programmes;
- in due course, will consider adequacy of cash provision on programmes.

Meantime, uncertainties due to, for example, inflation, are one reason for large Contingency Reserves in later years; makes for realistic planning totals.

8. NIS reduction: effect on public expenditure?

[Programmes will be reduced to reflect reduction in NIS paid by public sector. First estimates of effect (included in post-Budget revised planning totals) is some £360 million in 1982-83 and £450-500 million in later years.]

Government's intention in reducing NIS is to help private industry, not public sector. Effect of clawback on public sector wil leave its position broadly unchanged. (See also P2).

9. Not enough capital expenditure?

Government prepared to give priority to worthwhile capital projects wherever this can be done within overall spending totals. Plans do allow for changes between 1981-82 and 1982-83 as follows:

- public sector spending on new construction increased by 14 per cent;
- nationalised industries investment to rise by 26 per cent;
- increase in housing investment output [NOTE: if LAs take full advantage of receipts from sales, gross new investment can be as high as £3 billion next year];
- slight increase in work done on water and sewerage projects even though provision reduced).

10. Cuts in capital

Some reductions in cash provision necessary, but recent falls in tender prices (following sharp increases between 1978 and 1980) will mean that programmes mainly affected (roads, water, local environmental services) should be carried out as planned. Planned capital expenditure also reflects decline in needs since early mid-1970s (e.g roads, schools). Planned spending should not jeopardise future standards and availability of public amenities and services.

11. TCSC criticise change to cash planning?

The TCSC do not dispute decision to change to cash planning. They are concerned rather with presentation of figures.

12. Cash planning means concentration on first year, not enough on services in later years?

Government recognise case for medium-term planning. But planning must be related to availability of finance as well as prospective real resources. Cannot accept unconditional commitment to forward plans for services. Volume plans formerly had to be cut when conflicted with financial constraints - e.g after IMF intervention in 1976.

13. Cash figures should be accompanied by constant price figures to give some idea of levels of service?

Constant price figures of limited value in new situation. Cash programmes intended to have primacy. Necessary to get away from old system of 'volume' planning and destroy idea that programme managers automatically entitled to be compensated for effects of inflation by revaluing their programmes. In any case old 'volume' figures not a measure of level of service. Simply measured resources put into programmes - inputs. The level of service provided - output - takes account not only of resource inputs, but efficiency and effectiveness of their use. We are continuing to review and develop use of output measures in planning and management of public expenditure.

14. End-year flexibility?

Possibility of end year flexibility is being looked at again. There could be some managerial advantages in such a scheme. But we also have to consider question of cost.

15. Cash limits 1982-83 and public sector pay?

(See K10-12).

16. Cut public sector pay bill/administrative costs of central government?

Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on. Provision for public service pay increases next year limited to 4 per cent. Administrative costs ae not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

LOCAL GOVERNMENT

17. Overspending in 1982-83? Government response?

Disappointed that preliminary figures show local authorities are budgeting to spend above Government's plans. Overspending particularly to be regretted since plans are realistic. Local authorities could achieve them if they try hard enough. Government's response to combat overspending will be announced shortly. [NB. Scottish Secretary may announce this week holdback of grant from some authorities.]

18. Government's plans for later years are unattainable?

[Press reports have claimed that White Paper implies 9 per cent total reductions in 1983-84].

Government's plans for 1983-84 are fair and realistic - they are 4 per cent higher than for 1982-83. [IF PRESSED: if this means that LAs are faced with need to make substantial economies, reason will be LA's overspending in 1982-83].

19. Large rate increases this year are Government's fault?

Not at all. If local authorities had sought to spend in line with Government's plans, rate increases should be very low. Where they are high, it is because local authorities have chosen to overspend.

20. Effect of NIS reduction on local authorities?

As Chancellor announced in Budget, lower NIS payments by local authorities will be offset by a reduction in RSG. This will mean that local authorities overall are neither worse nor better off as a result of decrease in NIS. [IF PRESSED: we are consulting local authorities about details.]

21. Green Paper on Domestic Rating System: Government response?

Government is considering carefully all representations received. We wish to produce proposals for a scheme that will remedy shortcomings of present system while commanding wide support.

F CIVIL SERVICE STAFFING AND PAY

[Functions being exercised by HM Treasury since 16 November 1981: (1) civil service manpower, pay and allowances, retirement policy and superannuation scheme, staff inspection and evaluation, (ie central allocation and control of resources), (2) responsibility for Central Computer and Telecommunication Agency and Civil Service Catering Organisation (3) civil service industrial relations. Functions being exercised by Management and Personnel Office (MPO): (1) civil service efficiency, personnel management, recruitment and training, (2) Office of Parliamentary Counsel (3) machinery of government questions.]

1. Civil Service too big/does too much/is over staffed?

Since the Government came to office, Civil Service has been reduced by nearly 8 per cent to 675,400. This is smallest for 15 years. This results from a reduction in functions, privatisation and improvements in efficiency. We are on course to achieve our aim of having a Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean the smallest Civil Service since the end of the war.

2. Civil service pay: non-industrial civil servants

[Settlement date 1 April 1982]

Negotiations failed. Matter referred to arbitration and heard by Civil Service Arbitration Tribunal on 19 and 20 April. Award made known 23 April. Government considering this, and will announced its decision on implementation as soon as possible.

3. Civil Service pay: industrials

[Settlement date 1 July 1982]

Claim for increase in pay in line with inflation, a shorter working week and longer holidays, is under consideration.

4. Scott Report/Public sector pensions?

See K 18.

G SOCIAL SECURITY

1. Now that unemployment benefit is to be brought into tax why not restore November 1980 5 per cent abatement ?

Decision to abate UB was not simply taken as a proxy for tax but to reduce public expenditure and to improve incentives to find and keep work. (Chancellor's Budget statement in March 1980 made that perfectly clear.) Those reasons remain valid. Any improvement on rates announced would seriously worsen incentives. Cost too would be high - £60 million in a full year [net of reduced claims for supplementary benefit, but gross of tax].

2. Why cut child dependency additions to unemployment benefit?

[In line with practice in recent years, uprated level of child dependency additions to unemployment benefit (but not Supplementary Benefit) has been abated by amount of increase in Child Benefit. In consequence, CDAs will be reduced from current level of 80p to 30p next November.]

The child dependency additions to unemployment benefit are being phased out, and will eventually be replaced entirely by Child Benefit. In this we are following practice adopted by last Labour Government.

3. Increasing supplementary benefits by less than forecast movement of prices hits at poorest of the poor, and breaks an election pledge?

The benefits will retain their value in real terms. Beneficiaries receive not only their scale rate entitlement but a cash payment to cover their housing costs in full. By uprating scale rates in line with RPI which includes housing costs, there has been some double provision. The change corrects that. The abatement of ½ per cent represents a broadly based adjustment for the likely relative movement of housing costs to November 1982. [NOTE: we do not want to make public a forecast of a housing index.]

4. Death grant - increase to realistic level?

[Social Services Secretary on 30 March published consultative document on the death grant, asking for comments by 30 July.]

Social Services Secretary would welcome comments on his consultative document on death grant recently published. As we have always made clear, our aim is to redistribute the resources now devoted to death grant in a more sensible fashion - we cannot afford to add to those resources.

H PUBLIC SECTOR BORROWING

1. Why was 1981-82 PSBR forecast in 1982-83 FSBR so far out?

[1981-82 PSBR estimated outturn published in 1982-83 FSBR £10.6 billion; April 1981 to March 1982 results reported in 22 April press notice £8.6 billion. Main causes of reduction from FSBR figure were reduction in central government own account borrowing of £1.3 billion and reduction in local authority borrowing requirement of £0.4 billion].

Forecast based on best estimates at time of 1982-83 FSBR. Always considerable uncertainties at time of Budget. [IF PRESSED: Always difficult to predict end-year flows of expenditure and receipts, and effects of Civil Service dispute on monitoring added considerably to uncertainties at time of FSBR].

2. FSBR estimated 1981-82 PSBR outturn presented artificially high to show declining PSBR between 1981-82 and 1982-83?

Not so. [See answer to question 1 above].

3. Interest rates will now fall?

Not necessarily. Many factors involved in deciding appropriate level of interest rates.

4. PSBR in 1982-83 needs revising?

[1982-83 FSBR shows forecast 1982-83 PSBR of £9.5 billion].

Not necessarily true that 1982-83 PSBR estimate would have been different had more accurate 1981-82 outturn been available. Figure of £9.5 billion was judgement of what could be financed in market at tolerable interest rates in all circumstances of time.

5. Implications for public expenditure in 1981-82 and 1982-83?

Not known exactly what 1981-82 outturn will be nor the implications for 1982-83, as will be some time before information on 1981-82 outturn will emerge. [IF PRESSED: It is estimated, on very incomplete information, that the planning total will fall from £105.2 billion in the FSBR to around £104.5 billion (around £104 billion was provisional estimate given in other briefing) and that ratio of public expenditure to GDP will fall from 45 per cent to 44½ per cent].

6. Effect of Civil Service dispute on PSBR?

PSBR in both years affected by Civil Service dispute. In 1981-82 some £¾ billion of receipts delayed from March 1981 were collected, but some £1½ billion of receipts due in 1981-82 will now be collected in 1982-83. Debt interest cost of the strike some £½ billion in 1981-82.

7. PSBR should be higher/lower?

Main criterion for judging appropriate size is scope for financing it without undue strain on interest rates. PSBR very much a 'broad brush' concept.

8. Fiscal policy should be based on cyclically adjusted/real PSBR?

Some merit in inflation-adjusted measure as indicator of fiscal stance in some circumstances. But there are dangers here: it would be quite wrong to expand PSBR in cash terms in response to an upsurge in inflation merely to keep inflation-adjusted measure constant. Policies intended to eradicate inflation, not to adjust to it.

J MONETARY AND FINANCIAL POLICY

1. Effect of Falklands dispute on markets?

[Interest rates are fluctuating at levels about $\frac{1}{4}$-$\frac{1}{2}$ per cent higher than before the crisis. No sign of base rate moves. FT industrial ordinary share index down over 20 points at lowest, but now recovered to previous levels.]

Markets uncertain, but initial shock seems to have been absorbed without significant ill-effect. Too early to say what long term effects will be, but Government determined not to be deflected from its path. Recent indicators good, eg RPI, money supply figures.

2. Prospects for Lower interest rates?

[Bank base rates reduced by $\frac{1}{2}$ per cent to 13 per cent with effect from 12 March. Have come down by 3 per cent from peak of 16 per cent last autumn. Market rates are roughly $\frac{1}{2}$-$\frac{3}{4}$ per cent higher than level just after Budget, largely in reaction to Falklands dispute].

Of course we want to see lower rates. Have seen significant reductions over past 6 months. But we must proceed cautiously if we are not to let up in the fight against inflation.

3. Will high and unstable US rates affect UK rates?

US rates not sole determinant of UK rates, but high US rates certainly an adverse development and in September were a key factor in driving our rates up. Recently, however, sterling has remained reasonably firm, probably helped by improved prospects for wage round, and good trade figures. UK interest rates eased against US trend; but we cannot insulate ourselves from difficult international background.

4. Falls in interest rates since New Year incompatible with strategy?

Taking account of all evidence, present levels of interest rates are consistent with policy of continuing downward pressure on inflation.

5. MTFS being quietly shelved?

[3rd MTFS states Government's objectives 'to reduce inflation and to create conditions for sustainable growth in output and employment', by 'steady but not excessive downward pressure on monetary conditions'. Key financial indicators are the monetary aggregates and exchange rate. Target range for growth of M1, £M3, PSL2 in period February 1982 - April 1983 of 8-12 per cent. Illustrative path of 7-11, 6-10 per cent in 1983-84, 1984-85. Targets for later years to be set nearer the time.]

No. Updated MTFS is realistic and flexible, describes how monetary policy operated in practice. MTFS serves useful purpose. Right to retain and adjust in light of experience.

6. Monetary targets discredited?

Monetary targets have important role in defining medium term direction of policy. But short term movements in monetary aggregates not always reliable guide to monetary conditions. Policy decisions based on assessment of all available evidence.

7. Overshoot of 1981-82 monetary target

[£M3 grew by 0.2 per cent seasonally adjusted in banking March; annual rate of growth since Feb 1981 (ie 1981-82 target period) 13.4 per cent; M1 fell by 0.7 per cent, 7.3 per cent since Feb 1982; PSL 2 rose by 0.6 per cent, 11.7 per cent since Feb 1981.]

Growth in £M3 was above top end of 1981-82 target range, even allowing for effects of Civil Service strike. At least part of excess reflects increasing market share of banks in mortgage lending. Also reflects longer term effects of institutional changes such as ending of corset, abolition of exchange controls and changes in savings behaviour. These factors imply higher monetary growth permissible for same increase in nominal incomes. [NB. Annualised rates of growth over 1982-83 target period on basis of one month's figures would not be sensible.]

8. Monetary conditions too tight?

Behaviour of exchange rate and money GDP as well as monetary aggregates suggest financial conditions have been moderately restrictive as intended. But bank lending still high, despite level of interest rates. Companies' financial position much stronger than a year ago. (See P3)

9. Bank lending

Still very strong. Part at least is substitution for lending by building societies and other forms of consumer credit. To extent that it is additional, adds to inflationary pressure, so must avoid premature relaxation of interest rates.

K PRICES AND EARNINGS

1. Inflation still higher than when Government took office?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 14.1 per cent.]

Average level of inflation will be lower under this Government than under its predecessor. This will be the first Government since the war that has achieved a lower rate of inflation than its predecessor.

2. When will single figure inflation be achieved?

[Year-on-year rate of inflation 10.4 per cent in March compared with 11 per cent in February, and 21.9 per cent in May 1980.]

Budget forecast is for year-on-year rate of inflation of 9 per cent by Q4 1982, falling to 7½ per cent by mid-1983. We expect rate of inflation to be below 10 per cent well before end of year.

3. What reason is there to expect a further decline in inflation?

Over the next year or so, moderation in unit labour costs should continue to exert downward pressure on the rate of inflation, as should weak commodity prices. Competitive pressures on firms to limit price rises are also likely to remain strong.

4. FSBR inflation forecast more optimistic than major outside forecasts?

Assessments released since Budget expect single figure inflation to be recorded this year (LBS, NIESR, P&D, Simon and Coats, St James). March CBI monthly trends enquiry showed, for second consecutive month, substantial decline in net balance of firms expecting to raise prices in next four months [Dec and Jan 47 per cent, Feb 40 per cent, March 32 per cent].

5. Effect of 1982 Budget on RPI?

Compared with full indexation of excise duties, direct effect of Budget is RPI reduction of 0.1 per cent (or an increase of 0.1 per cent including also the direct effect of the 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 0.8 per cent increase in the RPI (or 1.4 per cent including also 2 December measures).]

6. Effect of 1982 Budget on TPI?

Compared with full indexation of excise duties, direct effect of Budget is TPI reduction of 0.4 per cent (or increase of 1.1 per cent including also direct effect of 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 1.6 per cent reduction (or a 0.3 per cent increase including also 2 December measures).]

7. Nationalised industry prices

Nationalised industry price rises have been due in part to the ending of the previous Government's policy of artificial and distortionary price restraint. Rate of nationalised industry price rises generally is now coming more closely into line with the RPI. [See R15]

8. Current level of pay settlements?

In economy generally, settlements in last pay round averaged 8-9 per cent. Negotiators seem to be settling up to about a third lower in this round than they did in previous. And almost all settlements seem to be in single figures.

9. Private sector pay - the CBI's 7 per cent?

[CBI figures suggest that manufacturing settlements monitored since 1 August are averaging around 7 per cent.]

Settlements have been lower in recent months, reflecting an increasing sense of realism about pay. But the need is for continuing low settlements which are consistent with maintaining economic recovery and improving employment prospects.

10. Public sector pay

Government's approach to pay in the public services must take account of what the taxpayer can afford. Pay negotiations in the nationalised industries and local authorities are a matter for the parties concerned, as are the financial consequences of any settlements reached.

11. 4 per cent pay factor unrealistic/unfair?

Real incomes had risen to unsustainable level in recent years and public service pay increased relative to private sector since 1979. 4 per cent is broad measure of what Government thinks reasonable and can be afforded as general allowance in fixing the programme from which public service pay bill has to be met.

12. Nurses broken through the 4 per cent?

The 4 per cent factor is not a norm. Government recognises need for pay settlements to take account of market factors, including effect on recruitment and retention of expensively trained staff in NHS.

13. Average earnings index

[Year on year growth 11.3 per cent in February compared with 10.8 per cent in January, though (unpublished) underlying increase slightly less than in previous 6 months at just under 11 per cent.]

Recent buoyancy of earnings partly reflects increase in hours worked, which is an effect of the emerging revival of activity, particularly in manufacturing. Change over the 12 months to January straddles two pay rounds - not useful indicator of recent trends.

14. Comparison of TPI and index shows that real take-home pay has fallen over the past year

Yes. But follows growth of 17½ per cent in personal living standards in three years 1977-80.

15. Movement in TPI

Fact that TPI has been increasing faster than RPI (roughly 3¼ per cent faster over year to March 1982) reflects measures taken to restrain Government borrowing -essential if inflation is to be controlled.

16. Government aiming to cut living standards?

[Although RPDI was 1 per cent higher in 1981 Q4 than in 1979 Q1, it is likely to fall below the 1979 Q1 level during 1982]

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

17. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, evasion, administrative cost, and interference with market forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

18. Index-linked pensions and the Scott Report?

The Government is considering the whole question in the light of the Scott Report. Our aim is to ensure that public servants' pensions are fair to taxpayers, as well as to current employees and pensioners and their dependants.

BALANCE OF PAYMENTS

1. Will the freeze on Argentine assets affect the standing of the City?

We have not confiscated Argentine's assets, merely frozen them. This action was taken under extraordinary provocation; we believe the international financial community will understand this.

2. Does the freeze involve reintroducing exchange controls?

No. We are denying Argentina access to her assets which is the reverse of traditional exchange control - which controlled payments by UK residents to non-residents.

3. Balance of advantage favours Argentina in mutual freezing of assets?

Argentine retaliation will not affect UK economy as a whole. Although UK assets in Argentina greatly exceed Argentine assets here their assets here are highly liquid. The crisis and our action will greatly reduce Argentina's capacity to raise loans on the international markets. At least two Argentine public foreign borrowing operations amounting to $400 million have been suspended since the crisis began.

4. New Argentine financial restrictions?

[Reports that Argentina to issue dollar-denominated bonds to meet some current interest payments].

Payment to UK from Argentina already suspended by the Argentines. Reports are confused on details, but Argentina is clearly looking round for devices to avoid bankruptcy. Rest of world will draw their own conclusions about the credit-worthiness of the Argentine regime.

5. January trade figures

[Published 2 April]

Current account surplus in January estimated at £348 million, continuing the trend of strong surpluses. A visible trade deficit of £132 million was outweighed by projected invisible surplus of £480 million, swollen by EC budget refunds.

6. Exports

January export figures were erratically low, probably due to bad weather during first half of month. Necessary to wait for February figures for more accurate idea of recent export trends.

7. Imports

January import figures tend to confirm trend of last quarter 1981, reflecting increased demand for basic materials and other imports together with much less destocking.

8. Why is invisible surplus projection so high?

The projected invisibles surplus of £480 million takes into account further EC budget refunds of over £800 million in Q1 1982 (see N4). Earnings of overseas oil companies operating in the North Sea are likely to have been depressed, reducing debits on the interest, profit and dividends account.

9. Balance of payments Q4 1981

Current account established to have been £1,541 million in surplus in Q4, including a visible trade surplus of £623 million. Total 1981 current account surplus £8 billion.

10. Prospects for 1982?

[FSBR projects surplus of £4 billion on current account; average margin of error is £2 billion. Outside forecasts range from near balance to £7 billion surplus.]

Very uncertain, but nearly all forecasts see continued surplus - albeit below last year's record level.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate

[Since last autumn sterling has remained broadly stable. The average £ effective rate in Q1 1982 was over 10 per cent lower than in Q1 1981. Recent lows were $1.7470 on 6 April, DM 4.07 on 20 October. Highs were $1.97 on 30 November, DM 4.407 on 9 February. Rates at noon on 23 April were $1.7710, DM 4.248 and an effective of 89.99. Reserves at end March stood at $19.0 billion, compared with $23.4 billion under the old valuation at end February.]

The Government has no target for the exchange rate. The rate is taken into account in interpreting domestic monetary conditions and taking decisions on policy.

2. Effects of Falkland Islands dispute on sterling

Hardly surprising if the uncertainties had some unsettling effect. But markets are aware that the underlying position of the UK is strong, with inflation falling, growth picking up and a healthy balance of payments surplus. The Falklands dispute is small in relation to this overall macroeconomic picture, and there is no question of it requiring any change in our basic economic strategy.

3. Bank of England intervening to support the rate?

Policy is unchanged. The Bank do intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions are unsettled. But as the Chancellor has already stated we have no target - undisclosed, secret or otherwise - for the exchange rate.

4. Concerted intervention to reduce the value of the dollar?

All the experience in recent years is that exchange rates for major currencies cannot be manipulated by intervention alone. Intervention can help to steady markets, but not counter major exchange rate trends. That takes changes in real policies, affecting interest rates, monetary conditions and fiscal policies. Lower US inflation is in everyone's interest: the matter for real concern is the US fiscal/interest rate mix, a problem all countries are familiar with.

5 Sterling should join the EMS?

[See N10-11]

6. Lower the exchange rate to help UK competitiveness?

Effective exchange rate is now about same as when Government came to office. So any loss of competitiveness since then is entirely due to our paying ourselves more than we can afford. Only way to achieve lasting gains in competitiveness is by cutting inflation and bringing costs under control.

Why has revaluation of reserves led to such a large fall?

[Revaluation reduced reserves from $23.2 billion to $19.0 billion, a reduction of $4.2 billion.]

Because of the rise in the dollar since March 1981 the value of our non-dollar convertible currency holdings as expressed in dollars is less. At the same time the value of each dollar's worth of reserves is more. Similarly the dollar price of gold has fallen considerably in value over the past year. (Gold held in the reserves (other than that swapped for ecus) has been revalued at 75 per cent of the final fixing price on 31 March, according to the usual formula used in the annual revaluation.)

8. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to $14 billion by end of 1981. This has been more than achieved - external debt is now around $13½ billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. 'Mandate negotiations'

At meeting of Foreign Ministers on 23 March, Presidents of the Commission and Council put forward (on a personal basis) a possible arrangement for future refunds to the UK. Foreign Ministers greeted the proposals with interest, and agreed to study them further at their meeting on 27 April.

2. Link with CAP prices?

All member states agreed that the three chapters of the mandate (development of Community policies, agriculture and the Budget) must be taken together. The agricultural chapter and the budget chapter will therefore be carried forward in parallel.

3. ~~Net UK contribution to community too high~~?

A lot lower than it would have been without the refund agreement of 30 May 1980.

4. UK refunds in respect of 1981

Commission paid us before 31 March £813 million for supplementary measures as first instalment of our refunds in respect of 1981. This represents 81 per cent of our entitlement for that year. Our net contribution for 1981-82 is now put at some £200 million - very substantially less than it would have been without the 30 May 1980 budget agreement.

5. UK a net recipient in 1981?

[Commission's latest estimates suggest that we were small net beneficiaries in 1981]

On our figures, we remained a small net contributor to the allocated Community budget. We also, of course, contribute to aid etc. which is part of the unallocated budget. Very satisfactory that the outturn was better than expected: for we remain one of the less prosperous member states.

6. Budget refunds reduced if net contribution less than originally estimated?

The UK is clear that minimum net refunds payable under 30 May agreement are 1175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

7. Do supplementary measures grants lead to additionality?

There is additionality in that refunds enable public expenditure in the regions and elsewhere to be higher than would otherwise have been possible.

8. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

9. Costs of CAP to UK consumers

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

EUROPEAN MONETARY SYSTEM

10. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

11. Join the EMS for exchange rate stability?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

INDUSTRY

1. Budget does not do enough for industry?

Budget measures directed at helping business and will cost £1 billion in 1982-83. On indexed basis over 2/3 of Budget's net revenue cost will go to help businesses. But main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates.

2. Prospects for industry-recovery?

Fall in output has now come to an end. Industrial production in Q4 1981 ½ per cent up on Q3 and some 2 per cent up on H1. Budget forecast suggests there may be 3 per cent increase in manufacturing output in 1982 as a whole. March CBI enquiry and FT opinion survey encouraging (see B3).

3. Company financial position?

[Non-oil industrial and commercial companies (ICC's) gross trading profits (net of stock appreciation) rose by over a quarter between 1H and 2H 1981, but from a very low base - ICC's real rate of return just 2½ per cent in 1981. ICC's finances showed some weakening in 4Q reflecting slowdown in destocking and unwinding of civil service dispute, but finances better in 1981 as a whole -

	1980 £	1981 £
Net borrowing requirement (+)/repayments (-)	+5.7 bn	+4.4 bn
Financial surplus (+)/deficit (-)	- 1½ bn	+1.2 bn]

Increase in profits (albeit from low level) encouraging. Some apparent deterioration in financial position reflects slowdown in rate of destocking, and effects of unwinding of civil service dispute (which delayed companies' tax payments), but companies' finances much healthier in 1981 than year before.

4. Rate of return still too low?

[Real pre-tax rate of return of non-North Sea ICCs rose marginally to 2½ per cent in 1981 Q3 compared to 2¾ per cent in Q2 (a record low).]

Yes, but Government can only help in limited ways such as reducing burden of NIS and creating the climate for lower interest rates. Further improvements in ICC's profits and real rates of return can be expected, provided recent productivity gains and trend towards moderate settlements continue.

5. High interest rates damaging for industry and investment?

[Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.]

Budget measures have eased pressure on interest rates, and the recent ½ per cent fall in the banks' base rates is encouraging. But Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Continuing relatively high level of interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFS. (See brief J).

6. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken so far to over ninety. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme this year (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

7. Response to Loan Guarantee Scheme?

Scheme operating successfully. We have already issued more than 3,350 guarantees - about half to new businesses. Total lending under scheme is just under £114 million. Budget provided for the lending ceiling - in year to May 1982 - to be raised from £100 million to £150 million. Further £150 million will be made available in following year. Three more banks admitted to scheme last week making total of thirty financial institutions now participating.

8 Progress with setting up Enterprise Zones?

Excellent progress being made. All of eleven zones now in operation, following designation of final zone - Isle of Dogs - last week.

9. Response from private sector?

Response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

R NATIONALISED INDUSTRIES

GOVERNMENT RELATIONS WITH NATIONALISED INDUSTRIES

[Industry Secretary announced 15 March that Government is to change its dealings with nationalised industries by agreeing objectives with each, putting more emphasis on efficiency by increasing Monopolies and Mergers Commission references and through board structures, and by strengthening business expertise in Whitehall.]

1. Whitehall making a take-over bid for the industries?

Monitoring not same as interference in management. Crucial for officials and Ministers to be informed about the industries' progress and about any problems that arise; no intention to interfere with proper role of management within the industries.

EXTERNAL FINANCING LIMITS

2. EFLs for 1982-83 and future years?

Nationalised industries' total external finance increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes), £1.7 billion in 1983-84, £1.2 billion in 1984-85 - a total of over £4 billion over the three years of the Survey. Government has given full recognition to problems faced by the industries in a period of recession. Increase in 1982-83 was roughly half what the industries bid for.

3. Unreasonable to reduce EFLs following NIS cut?

Reduction in the National Insurance Surcharge was designed to benefit private sector; not the intention that public sector should gain from it. Amendments to EFLs announced 7 April are offsets to the addition to the industries' internal resources that would have followed the NIS cut. No industries will be worse off than previously, and their plans should be unchanged.

4. Pay assumptions?

Government has not set pay or any other assumptions for the industries. Moderate pay settlements - and restraint of current costs generally - essential if investment programmes to be maintained and prices to consumers kept down.

INVESTMENT

5. How robust are the forecasts of nationalised industry demand/contributions to public expenditure, given the recent track record?

Plans published in PEWP at Budget time considerably less optimistic than those published last year. In particular, in increasing substantially the external finance available to the industries in each year of the Survey, Government recognised effect of lower demand on the industries' internal resources - now expected to be well below the levels in last year's White Paper (by about £2 billion in each of the years 1982-83 and 1983-84). The industries' external financing needs still expected to decline over Survey period, but from higher base and at more gradual rate than forecast last year.

6. Investment plans unlikely to be attained?

No Government can unconditionally guarantee a level of investment by the nationalised industries. Approved levels set out in White Paper are consistent with the industries' agreed external financing requirements, on the basis of their internal resource forecasts. But perfectly possible that plans might need to be revised, for example if the industries fail to restrain their current costs, including pay.

7. But shortfall in capital spending 1981-82?

[Figures in FSBR imply shortfall of £¾ billion.]

Not easy to establish firm reasons after the event. Such evidence as we have suggests a mixture of reasons. Most important has been cut in investment in response to changed circumstances such as lower market demand. These cuts have been extraneous and have not borne any direct relationship to EFL pressures. Other cuts have been for wholly beneficial reasons, such as lower than expected inflation and cost savings.

8. Take nationalised industry investment out of PSBR?

Real problem of pressure on resources cannot be solved by changing statistical definitions. Since nationalised industries are part of public sector, their borrowing - for whatever purpose - must by definition form part of public sector borrowing requirement.

9. Private finance for NI investment?

[NEDC Working Party's study of nationalised industry investment was discussed at Council's 5 October meeting: agreed there should be review of progress to be completed by June 1982.]

We have indicated willingness to consider new financing proposals. Direct market finance can only be justified if there is genuine element of performance-related risk for investors, in order to improve incentives to management efficiency, and if new forms of saving are tapped, to avoid adverse monetary consequences. Market financing does not of itself lessen burden on financial markets.

10. Does Government propose to sell shares in BT?

Recent press reports are speculative. As the Chancellor announced in Budget statement, detailed work is proceeding on 'Buzby bond'. Government continues to examine ways in which market pressures could be brought to bear on nationalised industries, including BT.

11. Finance more nationalised industry investment by cutting current spending?

Yes. As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

NATIONALISED INDUSTRY PAY AND PRICES

12. Nationalised industries' prices

Nationalised industries' price rises have been due in part to ending of previous Government's policy of artificial and distortionary price restraint between 1974 and 1980. But since middle of 1980-81, gap between NI price increases and RPI has narrowed. Artificial price restraint would result in unacceptable increased burden on taxpayer and distortion of market forces.

[CAUTION: gap between NI and 'all items' RPI could widen again in near future. Factors include LT fare increases in spring, winter electricity discount scheme ending, dropping out of RPI of last year's double revalorisation of excise duties.]

PRIVATISATION

13. What further sales expected?

Special sales of assets in 1982-83 forecast at around £700 million and around £600 million in each of the later years. These figures well above those in last White Paper. This reflects primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - to be made possible by Oil and Gas (Enterprise) Bill currently before the House.

14. Net figure for special asset sales this year?

[Public Expenditure White Paper showed net sales of only £50 million in 1981-82; latest estimate included in FSBR is -£100 million - ie £100 million net purchases.]

Low net figure is result of decision not to proceed with further programme of advance oil sales in weak market. Gross figure expected to be in line with £500 million target included in last White Paper; will include proceeds from Cable & Wireless, sale of Amersham International Limited and National Freight Company Limited, sale of Government's shareholding in British Sugar Corporation, and further sales of motorway service areas long leases.

15. Government simply selling valuable national assets to achieve PSBR target?

Of course the cash is welcome, but benefits run wider than that. Not only will any future borrowing by these undertakings be outside the PSBR, so reducing burden on taxpayers, but the organisations concerned will be made more responsive to market forces and thus have greater incentives to improve efficiency.

16. Government running into heavy weather over sale of Wytch Farm?

The British Gas Corporation is proceeding with arrangements for sale of the Government's interest in Wytch Farm. It is too early to say when the sale will take place.

17. Special disposals programme just a subsidy for speculators?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices where shares first traded.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially when company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares.

S NORTH SEA AND UK ECONOMY

1. In view of recent falls in price of oil, why did HMG not reduce tax burden on North Sea oil producers?

[Budget tax changes included abolition of Special Petroleum Duty, increase in Petroleum Revenue Tax rate from 70 per cent to 75 per cent, and new system for advance payments of PRT (all from 1 January 1983), plus smoothing of PRT payments from July 1983 (this improves HMG's cash flow at companies' expense). Changes reduce the marginal rate of tax (from 90.3 to 89.5 per cent); involve slight fall in Government 'take' (no change 1982-83, costs £70 million 1983-84).]

Recognise need for tax structure robust to both falling and rising prices. Detailed study showed us that under new structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that new tax structure will provide more secure and stable regime.

2. Onerous tax system damaging future field developments?

[Shell/ESSO announcement plans for Tern shelved partly because of tax system].

Other adverse factors - falling oil prices; high development costs - much more important. No evidence that tax system alone is inhibiting future development.

3. Government has missed opportunity to simplify North Sea fiscal regime?

The oil industry has made it clear that it would not welcome a structural upheaval. Would create serious uncertainty and major transitional problems.

4. Impact of falling oil prices on Government revenues and Government strategy?

Other things being equal, lower oil prices will reduce Government revenues from the North Sea. Treasury has estimated that each $1 off the price directly reduces revenue, other things being equal, by £250 million in first year and £350 million in full year. Chancellor warned in his Budget statement he could not rule out possibility of having to take action to correct the fiscal balance if there were to be a marked and prolonged fall in oil prices. But falling world oil prices are good for the world economy. We will benefit from that - not only from impact on activity, but also lower oil prices will help in reducing inflation.

5. Implications of OPEC production limitation agreement for North Sea oil prices?

Remains to be seen whether the agreement will hold, and whether world oil prices will harden as a result.

6. Benefits of North Sea should be used to strengthen the economy?

[FSBR projections (in money of the day) of Government revenues from North Sea: £6.4 billion in 1981-82, £6.2 billion in 1982-83, £6.1 billion in 1983-84, and £8.0 billion in 1984-85. Lower than last year's projections, principally because of downward revision to oil price expectations. Projections already incorporate fall to $31 a barrel for Forties oil. Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise before 1985.]

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

7. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

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

North Sea revenues are already committed. Setting up a special Fund would make no difference. More money would not magically become available. So the money for this Fund would have to come from somewhere else. This would mean higher taxes or lower public expenditure, if public sector borrowing is not to rise. If borrowing did rise, then so would interest rates. Not obvious that net effect would be good for investment.

9. Are we really any better off for our North Sea Oil?

We are better off with oil - at current oil prices - than we would have been without it. We have been spared the fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil is costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for the possession of oil to require a contraction in our industrial base.

WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Government will have no choice but to reverse policies now unemployment has risen to post-war record levels in many Western countries?

Unadjusted unemployment exceeded 10 million in USA and 1 million in Canada in January. It exceeded 2 million in Italy in September, 2 million in France in October, and 1.9 million in Germany in February. Highest ever unemployment levels in Canada, France, Italy and UK and highest in USA and Germany since the War.]

No indication of a widespread departure from consensus achieved last year (eg Ottawa Summit, IMF Interim Committee) about need for prudent fiscal and monetary policies to bring down inflation.

2. Anti-inflation policies not working?

[Year on year consumer price inflation in major countries fell to 8.5 per cent in February. Underlying rates falling in US. OECD and IMF expect some decline in 1982.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980: some decline expected 1982.

3. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

4. Other countries giving priority to reducing unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

5. Other governments not following such stern policies as UK?

[Most major countries (US, Japan, Germany, Italy, Netherlands, Belgium, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Belgian government has used its special powers to freeze prices temporarily and severely curtail wage increases for rest of 1982.]

Most governments presevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

6. UK is alone in Europe. Even Germany announced investment/employment scheme?

UK far from alone. Almost all European governments working to curb public spending, budget deficits and monetary growth. Netherlands has just agreed to measures which will reduce PSBR by about 0.9 per cent of GDP below what it otherwise would be. French government has set limit on its budget deficit for 1983 of 3 per cent of GDP. German government plans to reduce its borrowing in 1982 Budget even in nominal terms by almost 30 per cent. Unlikely investment/employment scheme will entail any significant increase in borrowing - increase in VAT (by 1 per cent to 14 per cent) part of the package from 1 July next year. Impact on employment remains to be seen.

7. Prospects for UK economy worse than for other countries?

No. Treasury and most independent forecasters expect UK growth this year of about 1½ per cent rising to an annual rate of 2 per cent by early next year. This is very closely in line with the OECD's forecast for OECD Europe. Unemployment is expected to rise in all major countries except Japan. UK inflation (GNP deflators) likely to be around the OECD average and below that in France, Italy and Canada.

8. Prospects for US economy?

[In March US industrial production fell 0.8 per cent, to 8.3 per cent below July's peak; February's rise was shown to be a statistical blip on the chart and on 17 April Treasury Secretary Regan pronounced the economy 'dead in the water'. Seasonally adjusted unemployment is now 9 per cent of the labour force. Inflation fell for the 5th consecutive month to 7.6 per cent in February.]

Continued decline in inflation is good news; wage settlements in which unions have given job security priority over wage increases are contributing impressively to this decline.

9. US Budget compromise?

[Discussions continue: extra revenue proposals include 4 per cent supertax on incomes over £22,000, higher taxes on tobacco, liquor and oil imports; unspecified cuts in planned defence and Social Security spending also mooted.]

Firm monetary policy needs to be backed up by tighter fiscal policy. Hope that Congress and Administration soon reach an agreement that will reduce federal deficits and uncertainty in the financial markets. High US interest rates in no-one's interest.

10. Recent international interest rate developments?

True that US interest rates rose earlier this year. But prime rates are well below their peak of 21½ per cent last summer (currently 16½ per cent)

11. Prospects for international interest rates?

Always difficult to force interest rates with certainty, but firm and balanced policies should over a period bring lasting reduction in both inflation and interest rates.

12. OECD forecast leaked?

[Some OECD forecasts on the world economy have been leaked to The Times which published them on 23 April, with one misprint.]

Can neither confirm nor deny accuracy of press report of unpublished forecast by OECD. OECD's twice-yearly Economic Outlook still being prepared; not due to be published until July.

[A]IDE MEMOIRE ON THE UK ECONOMY

26 April 1982

PRESENT SITUATION

Clearly a range of outside forecasts; from ITEM and CEPG the more pessimistic to Liverpool more optimistic. Most major post-Budget assessments (LBS, NIESR, St James, P&D, St J) judge impact of Budget and falling oil prices favourable. Output by those groups forecast to grow about 1½ per cent in 1982 (cf FSBR's 1½ per cent), inflation to fall to single figures by end 1982 (cf FSBR's 9 per cent in 4Q 1982); very much in line with FSBR. CEPG broadly in line on inflation prospects, but see little prospect of any growth in output in 1982 or 1982. All groups expect continued rise in unemployment (UK adult sa) during 1982 to around 3 million. Forecasts for 1983 vary, from some groups expecting further rise (CEPG, NIESR, ITEM) to others (P&D, Simon and Coates) expecting some slight decline (roughly 50,000-100,000) and Liverpool expecting fall of 400,000.

GDP output estimate rose in both Q3 and Q4 1981. Level in Q4 some 1 per cent above Q2. Recent months' industrial output figures affected by bad weather, car and rail strikes. Nevertheless, Q4 1981 manufacturing output some 2-3 per cent above low point in Q1 1981.

Consumers' expenditure was unchanged in Q1 1982: continuing the flat trend of the last 2-3 years. Retail sales in Q1 1982 rose 1 per cent returning to the level of a year ago. The volume of visible exports in the last few months of 1981 were high compared with the level earlier in that year but there was a sharp drop in this volatile series in January 1982. Latest evidence indicate that there has been a significant rise in the volume of visible imports since the middle of 1981. DI investment intentions survey conducted in October/November suggests volume of investment, by manufacturing, distributive and service industries (excluding shipping) will rise by about 2 per cent in 1982 following a fall of about 5 per cent in 1981. A large rise is tentatively expected in 1983. Investment by manufacturing (including leasing) is expected to rise during 1982, but for the year as a whole it is likely to be 1 per cent lower than 1981. An appreciable rise is expected in 1983. Manufacturers', wholesalers' and retail stocks dropped by £25 million (at 1975 prices) in Q4 1981 the smallest quarterly fall in the last two years of continuous destocking.

Unemployment (UK, seasonally adjusted excl, school-leavers) was 2,822,500 (11.8 per cent) at March count, up 5,000 on February. Vacancies were 110,600 in March.

Wholesale input prices (fuel and materials) fell 2 per cent in March causing the year-on-year increase to dip to 8 per cent. Wholesale output prices rose ½ per cent in March but fell to 9½ per cent above a year ago. Year on year RPI increase fell to 10.4 per cent in March. Year-on-year increase in average earnings was 11.3 per cent in February. RPDI was flat in

the last three quarters of 1981; it fell 2 per cent between 1980 and 1981 after rising 17 per cent between 1977 and 1980. The savings ratio fell 0.7 points to 13.1 per cent in Q4 1981.

PSBR £8.6 billion and CGBR (unadjusted) £7.6 billion in the financial year 1981-82 but both distorted by the effects of the civil service dispute.

In banking March Sterling M3 and PSL1 both rose 0.2 per cent while PSL2 rose 0.6 per cent and M1 fell by 0.7 per cent.

Visible trade has showed a surplus of £0.5 billion on the 5 months from September 1981. Current account surplus over same period of £2 billion and likely surplus in 1981 as a whole £8 billion. UK official reserves following revaluation were $19.0 billion at end-March. At the close on 23 April the sterling exchange rate moved downwards to $1.7715 while the effective rate fell to 801.8.

Econ Pol
Strategy

CONFIDENTIAL

Prime Minister (2)

MS 23/4

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Michael Scholar Esq
Private Secretary
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LONDON SW1

23 April 1982

Dear Michael

... I am enclosing a copy of the latest Pay Brief.

Copies also go to the Private Secretaries to Members of E, E(PSP) and E(EA).

Yours

Marie Fahey

MISS M C FAHEY
Private Secretary

PAY BRIEF: POSITION AT MID-APRIL

SETTLEMENTS

1. Since the March pay brief 151 settlements covering 748,000 employees have been recorded. In the private sector (140 settlements covering 612,000 employees) the weighted average level of settlements in the last month was 8%. The average in the public sector (11 settlements covering 136,000 employees) was just over 6½%. The principal settlements were London Clearing Banks (151,000) at 9%, Road Haulage (97,000) at 6.7% and Marks and Spencer (45,000) at 13.5% in the private sector and British Shipbuilding (67,000) at 6.5% in the public sector.

2. The cumulative weighted average level of monitored settlements for the whole economy this pay round - 646 settlements covering 4,263,000 employees - is just over 7%, similar to the three previous months. ⅓ of employees about whom the Department expects to receive information have reached settlements.

3. In the private sector the cumulative average rose slightly to 7% after being at about 6½% for three successive months (620 settlements covering 2,567,000 employees). For manufacturing the average level is 6% and in non-manufacturing is just over 7½%. About ¾ of settlements (⅔ of employees) are covered by settlements in a 5% to 8% range. Few settlements are above 10%.

4. In the public sector (26 settlements covering 1,696,000 employees) the cumulative average remains at just over 7½%. LA manuals (1,077,000) at 6.9% continues to dominate the average. The average in the public trading sector is just under 7½% and in the services sector is just over 7½%.

5. Coverage: The limitations of the Department's coverage of settlements were explained in the March pay brief (para 5).

NEGOTIATIONS

6. In the PUBLIC SECTOR, unions representing Gas Supply manuals (17 January - 41,300) are to take their claim for increases in line with inflation, consolidation of bonus and other benefits unilaterally to arbitration. An offer of 7.8% to 9.1% on basic rates plus minor improvements, worth 7.6% overall on average earnings

(7.9% in a full year), has been rejected. Electricity Supply manuals (17 March - 94,000) are to ballot (without any recommendation from the unions) on an offer to increase basic rates by 5.1% to 6.6%, depending on grade, plus improvements to shift allowances; worth 7.1% overall on average earnings. Result is expected at end May. Electricity Supply power engineers (1 February - 29,300) have submitted a claim for a substantial increase in basic pay, reduced hours, improved holidays and other benefits. No offer was made at a meeting on 20 April. Unions on behalf of British Rail clerical and conciliation grades (20 April - 150,000) have submitted a claim for increases in line with inflation and other benefits. Negotiations are unlikely to begin before the current productivity issue is resolved. Unions representing London Transport rail supervisory and conciliation grades (19 April - 18,000) are considering an offer of 5% on basic rates and, if accepted quickly, improved fringe benefits and bonus arrangements, also a 1 hour reduction in the working week. The claim is for a substantial pay increase and shorter hours. Post Office UCW grades (1 April - 156,000) unions are considering an improved offer of 7% on all elements of pay plus £55 productivity bonus, worth under 8% overall on average earnings, with an undertaking to pay a similar bonus next year if productivity gains continue. The claim is for an increase of 20%. British Telecom engineers and technicians (1 July - 130,000) have submitted a claim for increases in line with inflation. An offer of 4.8% plus other improvements has been rejected. Next meeting 23 April. Four of the five unions representing BBC employees (1 April - 27,500) have accepted an offer of 6½% on basic salaries, and other benefits, worth 6.9% overall on average earnings. The other union (NUJ) has rejected the offer and has started a work to rule. The Non-Industrial Civil Service Unions (1 April - 520,000) have rejected an offer of no increase for some staff and between 1% and 5½% for others, together with improvements in skill and responsibility allowances and the introduction of certain other benefits, including season ticket loans. The cost is estimated at £170m or about 4% on the paybill. The claim is estimated to be worth on average about 14% on basic rates plus 1% for leave improvements. The unions formally requested arbitration and the hearing took place on 19 April. The result is expected in the next few days. Primary and Secondary Teachers E & W (1 April - 460,000) have rejected an offer of 3.4% on average earnings made in response to a claim for increases in line with inflation. The claim has been referred to arbitration which is unlikely to take place before late May. A similar claim by Primary and Secondary Teachers (Scot) (1 April - 55,000) has also been referred to arbitration following rejection of an offer of 3.9% to 6.7% (4% on average earnings). The hearing will take place on 22 April.

Unions representing Local Authority Building Trade Operatives (4 November - 76,000) are recommending acceptance of an offer of £4.60 (5.5%) on basic rates, improvement to the bonus calculator and a commitment to an hours reduction from November 82, estimated to be worth under 6.3% on average earnings overall. Similar offers have been made to Engineering Craftsmen (10,000) and Electricians (5,500). NHS Nurses and Midwives (1 April - 492,000) have been made a restructured offer of either 4% (for senior nursing managers) or 6.4%, except for tutorial staff who have been offered 4% plus incremental improvements; this represents 6.4% on the paybill. The claim is for 12% increase in basis rates, reduced hours and other benefits. A plea to the Secretary of State by the unions for more money to be made available was rejected. Management has refused arbitration. The Royal College of Nursing are to ballot members on the offer. The next joint meeting is 11 May. Members of the Confederation of Health Service Employees (COHSE) may take industrial action from 26 April. NHS Ancillaries (1 April - 210,000) and NHS Admin and Clerical (1 April - 125,000) have presented similar claims to that for nurses. Unions have rejected 4% offers. Further meetings have been arranged for 23 April and 6 May respectively. Members of COHSE are due to begin industrial action on 26 April. NHS Ambulancemen (1 April - 17,000) have submitted a claim for an increase in line with inflation, a shorter working week and other improvements. At a meeting on 20 April the unions rejected an offer of 4% plus the implementation of a salaries structure, worth 5% overall. COHSE members are due to begin industrial action on 26 April.

7. In the PRIVATE SECTOR, Building and Civil Engineering employees (28 June - 450,000) have opened negotiations with a claim for a substantial increase in minimum rates, reduced hours, improved holidays and other benefits, estimated to be worth over 35%. The employers are expected to respond at a meeting on 28 April. All three unions representing British Printing Industries Federation employees (24 April - 128,000) are recommending acceptance of an offer of £5.50 to £6.25 per week increases according to grade. The claim is for substantial increases, an extra week's holiday and other benefits. Chemical Industries Association process workers (8 May - 50,000) have received an offer of 7.3% on national minimum rates in reply to their claim for a substantial increase in rates, improved holidays and paternity leave. Union negotiators have accepted the offer and are to put it to members. Five of the six unions on behalf of Newspaper Publishers Association production workers (1 January - 33,000) have accepted the 'final' offer of 5% following ballots of members. The other union, SOGAT, is to hold another ballot

with a recommendation to accept. In Biscuit Manufacture (1 January - 39,000) agreement has been reached on an offer of 8.3% plus 1 extra day's holiday but this is subject to ratification by the unions. Mobil Oil tanker drivers (1 May - 500) have presented a claim for a substantial increase in basic rates and other improvements. An offer of 5% on basic rates has been rejected. A further meeting is to be arranged for early May.

PRICES AND EARNINGS INDICES

PRICES

8. In March the year on year increase in retail prices was 10.4% compared with 11.0% in February.

EARNINGS

9. In February the year on year increase in average earnings for the whole economy was 11.3% compared with 10.8% in January. However, the February figure was inflated by about ½ percentage point due to back-pay, mainly coal miners, and the underlying increase was about 10¾%.

REAL DISPOSABLE INCOME

10. The real disposable income - taking account of the changes in earnings, prices and taxes - of a married man on average adult male earnings with a non-working wife and two children under 11 (with no other tax liabilities or allowances and not contracted out of the State Pension Scheme) fell by about 3½% in the year to January.

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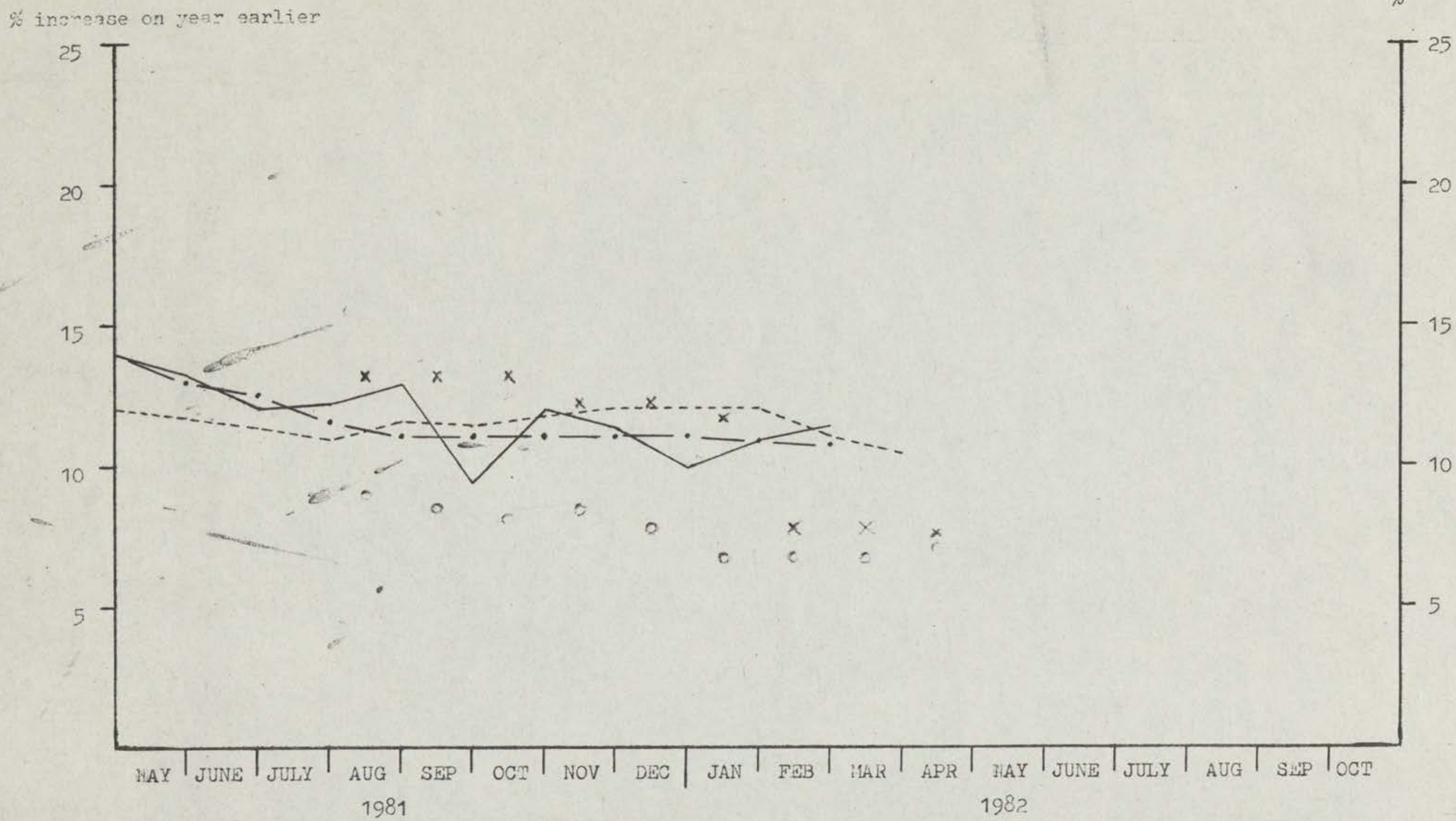
APPENDIX 3

TRENDS IN EARNINGS AND PRICES



- - - - Retail Price Index

——— Average Earnings Index (whole economy)

. ——— . Underlying rate of increase in earnings

× Public Sector Settlements)
o Private Sector Settlements) Cumulative Average Increase in Earnings

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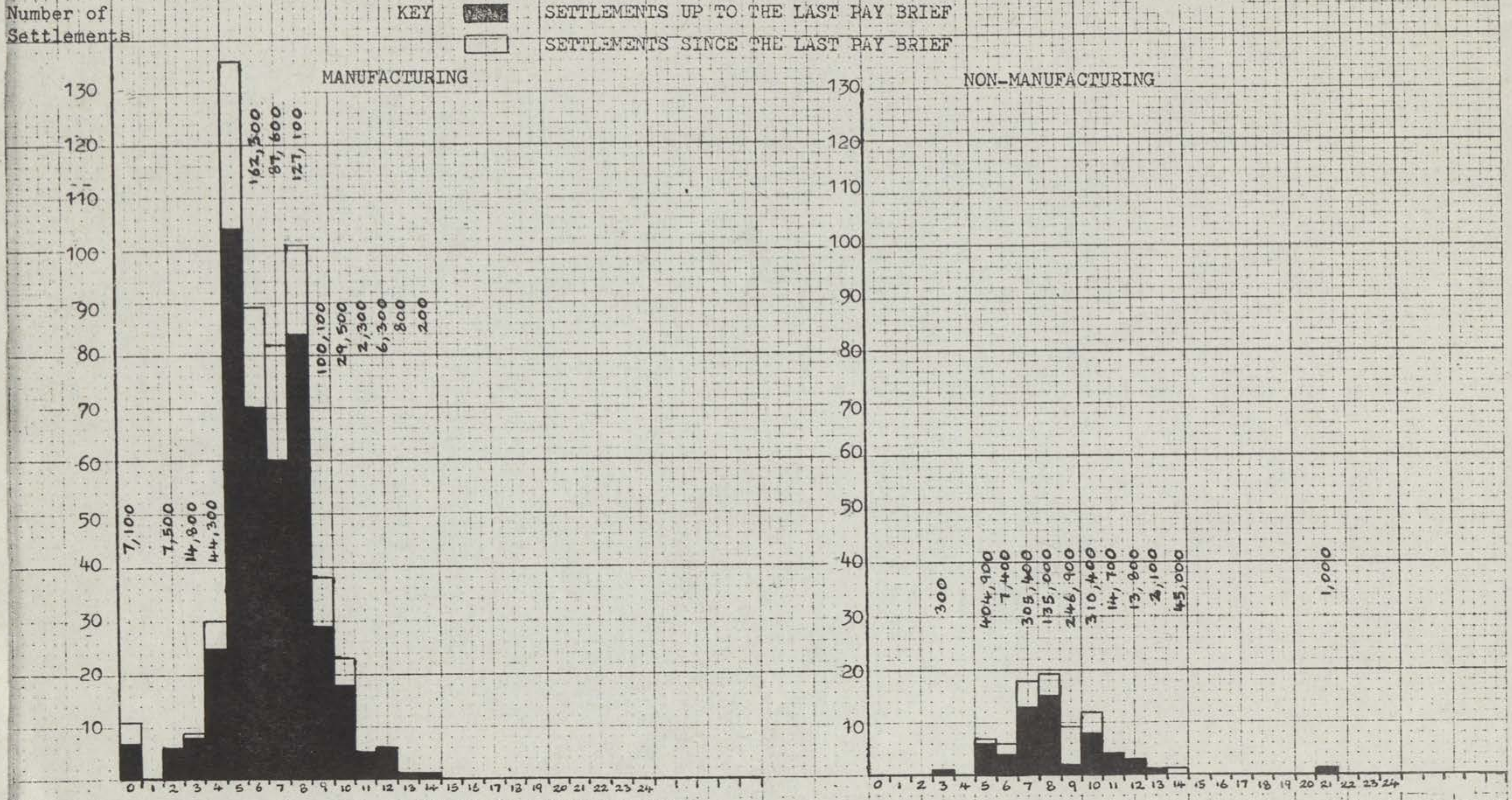
APPENDIX

DISTRIBUTION OF SETTLEMENTS IN THE PRIVATE SECTOR BY LEVEL OF SETTLEMENT FROM 1 AUGUST 1981



LEVEL OF SETTLEMENT (ROUNDED TO THE NEAREST WHOLE NUMBER)

NOTE - THE NUMBER OF WORKERS (ROUNDED TO THE NEAREST HUNDRED) AFFECTED BY THE SETTLEMENT IS GIVEN ABOVE THE APPROPRIATE INDICATOR.

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1/1

PPS/CHANCELLOR

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copied to:

Mr Salveson (for transmission to No.10)
PS/CST
PS/FST
PS/MST(C)
PS/MST(L)
PS/Home Secretary
PS/Lord Chancellor
PS/Foreign Secretary
PS/Secretary of State for Education and Science
PS/Lord President of the Council
PS/Secretary of State for Northern Ireland
PS/Secretary of State for Defence
PS/Minister of Agriculture, Fisheries and Food
PS/Secretary of State for Environment
PS/Secretary of State for Scotland
PS/Secretary of State for Wales
PS/Lord Privy Seal
PS/Secretary of State for Industry
PS/Secretary of State for Social Services
PS/Secretary of State for Trade
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 5 April, are sidelined.

B A Collins

B A COLLINS

E P Kemp

E P KEMP

19 April 1982

EB Division
H M Treasury
01-233-3364

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation and promotion of enterprise and initiative. Reduction of inflation requires maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Falkland Islands: Cost/Financing of operation?

No point at this stage in trying to assess the cost of our Falklands operation. But it is right to make two points crystal clear. First, there is no cash ceiling on the cost of the operation. Needs of the task force must and will come first. But secondly, its cost can and will be met in ways consistent with the Government's economic strategy. [IF PRESSED: Not all of the cost will be additional. At this stage the extra cost represents a very small proportion of the Defence Budget of over £14 billion. There is therefore no cash or budgetary problem immediately in prospect. Also complete nonsense to suggest that our ability to respond to the crisis in the Falklands has been weakened by the Government's so-called "cuts" in defence spending. Government has actually increased defence spending by over 85 per cent in cash terms and about 11 per cent in real terms since 1978-79.]

3. Are the financial markets right to be worried by Falklands crisis?

No. Of course, the markets are preoccupied with the dispute but it needs to be kept in perspective. The UK is basically in a strong financial position: inflation is coming down; interest rates were falling before the crisis; the balance of payments remains healthy; output is recovering. The disturbance due to the Falklands dispute is small in relation to the overall macro-economic picture. And the basic strengths in the economy have not changed (see Section J for latest interest rate position).

4. Relative importance given to inflation and unemployment?

Government is concerned about both. These are complementary not competing objectives; unemployment will not be reduced by relaxing struggle against inflation.

5. Contribution made by 9 March Budget?

Budget continues Government's medium-term strategy for economy. Designed to make further progress on inflation and restore base for economic growth, improved output and increased employment. Tax cuts and other measures designed to help both business and individuals, within responsible fiscal framework.

6. Reflationary/deflationary/effect of Budget on demand?

Oversimple question. Wrong to talk about what government is 'putting into' or 'taking out' of economy. Ignores links between fiscal and monetary policy and their effects through financial behaviour (interest rates and exchange rate), on economy. Budget's overall effect is to support sustainable recovery.

7. Effects of Budget and December announcements together?

[December announcement provided for £5 billion increase in public expenditure plans for 1982-83 and increased NIC rates yielding £1 billion extra revenue. But total Government revenue in 1982-83 now expected to be some £3½ billion higher than at time of 1981 Budget. Taking account of all these changes, pre-Budget PSBR for 1982-83 about £8¾ billion; post-Budget forecast about £9½ billion.]

No simple answer to this question. So much depends on base one starts from, and what counts as a policy change. But overall effect is reflected in a PSBR for 1982-83 only a little higher than planned in March 1981.

8. Not enough help for industry?

Main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates. In addition, specific Budget measures aimed at industry and business will cost about £1 billion in 1982-83. Signs of recovery in profits and financial position of industrial and commercial companies. (See also Section P).

9. Does more for industry than for people?

Help to industry is help to people. Higher allowances and thresholds more than compensate for inflation in last year and make up some of ground lost last year. Many other smaller changes (eg on charities) will help particular groups of people.

10. Another Budget pushing up prices?

No. Changes in excise duties slightly less than required for full revalorisation. 12-monthly inflation rate now 11 per cent (February figure published 19 March) - down from 12 per cent in January. Further fall forecast to 9 per cent by November 1982.

11. Effect of Budget on personal incomes, incentives etc?

See Section D.

12. PSBR for 1981-82 expected to be at least £1 billion lower than shown in FSBR?

[Figure to be published 22 April; CGBR for 1981-2 already published is over £1 billion lower than 1982 FSBR estimate]

See Section H.

13. Monetarism dead?

'Monetarism' a much over-used, misused and misunderstood word. Medium-term framework provides essential reference point for policy. Nonsense to suggest MTFS is being slavishly and dogmatically adhered to. Only right to take account of changing circumstances: that is what we have done. But such adjustments do not reflect any weakening in resolve to tackle inflation. Judged by results, policy is succeeding. Inflation has been reduced and is now coming down again.

14. Outlook for unemployment?

Budget forecast shows continuation of recovery; but it is not the practice to publish estimates of the overall effects of the Budget, or its individual measures, on employment or output. (See also Section C)

15. Recovery over?

[February industrial production figures, published 15 April, show only relatively modest recovery from strikes/severe weather affecting December/January levels; industrial production still at broadly same level as last autumn]

No. Underlying levels of output above that of last Spring. Most forecasters, along with FSBR, expect continuation of recovery this year; and some see growth accelerating in 1983 (see also Section B).

16. Not keeping to commitments to reduce expenditure?

Increases announced in Budget offset by reductions leaving totals still around £115 billion. FSBR shows declining ratio to GDP in future years. (See also Section E).

17. Armstrong/unified Budget?

[TCSC questioned Chancellor on this 5 April; further briefing will be supplied if necessary.].

Proposals have wide implications. Need careful consideration. Government does take account of tax and expenditure when taking decisions on each. Await TCSC report with interest.

18. Simulations on Treasury model/NEDC discussion

[Paper presented by Chancellor on various policy simulations using Treasury model presented to NEDC, 7 April]

Useful and constructive discussion at NEDC; Treasury paper favourably received by TUC. Simulations can prove nothing, but do suggest that relfation is not a lasting solution to problem of unemployment. What is needed is improvement in economic performance and faster adjustment to lower rate of inflation. TUC have suggested further dialogue/discussion of paper and calculations; results not therefore being published formally at this stage but being made available to both Houses of Parliament.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent position?

All three GDP measures were higher in real terms in Q4 1981 then had been earlier in year. GDP (output) in Q4 was nearly 1 per cent up on Q2 - the earlier low point. [IF PRESSED on apparent weakening of recovery (based on November/December/January industrial production) - see 2 below.

2. Recent industrial and manufacturing production figures show resumed decline?

[Latest industrial and manufacturing production figures show upward revision to January's index removing decline shown last month and some bounceback in February's index to level of last November.].

Latest figures (including revisions) show that as expected February saw some recovery from weather and strike effected levels at turn of year; and that effect of these in January was less than earlier presumed. CSO's press notice clearly states that underlying level of output above low point of spring of last year. Industrial and manufacturing output in 4Q 1981 some 2-3 per cent above low point earlier in year.

3. Business opinion

March business opinion surveys show encouraging improvement. CBI's monthly enquiry saw further improvement in order books, and rise (to 4 per cent) in net balance of firms expecting to increase output in next four months. FT business opinion survey corroborates this, and shows increased business optimism.

4. Other evidence of improvement in economy?

See Bull Points (following Section A).

5. Government assessment of prospects

[FSBR forecast (9 March) assesses recovery to have begun. Main points are:

	per cent increase on year earlier	
	1982	1983 H1
GDP	1½	2
Manufacturing output	3	2
Consumers expenditure	½	½
Investment (private sector and public corporation)	4½	5
Exports	3½	3

Forecast expects some stockbuilding in 1982, Government expenditure flat.]

FSBR forecast sees prospect of some recovery continuing into 1983. (Last two Government assessments of economy were broadly correct). Healthy rise in private sector investment and exports. Inflation well into single figures (7½ per cent) by mid 1983. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

6. Outside forecasts

[GDP profile in major post-Budget assessments:

	NIESR* (March)	LBS* (March)	St James* (March)	Phillips &Drew (April)	FSBR (Mar)
Per cent change 1982 on 1981	+1½	+1½	+1¼	+1¾	+1½]

Nearly all see prospect of continued recovery in 1982 in line with FSBR, (as always, a range, with Cambridge forecasts being the more pessimistic) and see inflation at 8-9½ per cent by Q4 1982 - also in line with FSBR. [See also C4 (unemployment), K4 (inflation) and L6 (balance of payments).]

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*Submissions to TCSC

C LABOUR MARKET

1. Recent unemployment figures?

[Unemployment (UK adult seasonally adjusted) rose by just 5,000 to 2,823,000 (11.8 per cent) in March. Total unemployment fell by 53,000 to 2,992,000 (12.5 per cent). Average monthly underlying increases in adult unemployment (after allowing for men over 60 transferring to long term Supplementary Benefit) are:

Thousands

1980	1981				1982
Q4	Q1	Q2	Q3	Q4	Q1
105	77	62	51	33	21]

Repetition of February's small increase in adult unemployment seasonally adjusted, encouraging sign that rate of increase slowed markedly further this year.

2. Vacancy figures disappointing?

[Vacancies (UK s.a) fell 2,400 in March to 111,000. Vacancy flow data for February (latest month available) show sharp rise in both inflow and outflow.]

Not too much should be made of one month's figures. Vacancies have been rising since middle of last year, and flow (ie vacancy turnover) has improved steadily.

3. Effect of Budget on unemployment?

Budget contributes to Government strategy of fostering conditions for sustainable growth. Help to business will lay foundation for more real jobs. Employment will benefit from some further improvement in activity. Proposed new non-profit-making scheme will enable local authorities and voluntary sponsors to provide many new jobs. (MSC to advise what possible: for illustration, Government prepared finance 100,000 at net additional Exchequer cost of £150 million).

4. Unemployment expected to continue rising rapidly?

[Outside forecasters see continued rise in registered unemployment during 1982 reaching about 3 million (UK adults) in Q4. Opinion divided for 1983, some pre-Budget forecasts (CEPG, Cambridge Econometrics, ITEM, NIESR) see rise continuing but at a slower rate, others broadly flat (LBS, St James); only Liverpool foresee a fall (400,000). Some post-Budget forecasts (P&D, S & Coats) expect slight (roughly 50-100,000) fall in 1983.]

Unemployment forecasts uncertain; independent forecasters encompass differing views for 1983 - several projecting stabilisation, some a [slight] decline. Rise in unemployment drastically reduced since end 1980. Clear evidence of further slowing down this year - Q1 1982 rise just 1/5 that in Q4 1980. Vacancies, short time and overtime all improved last year. Employment situation will benefit from some further recovery in activity this year.

5. Government forecasts for unemployment

[1982 PEWP uses working assumption of an average level of 2.9 million unemployed in Great Britain (excluding school leavers) in 1982-83 and rest of survey period. School leavers, adult students, temporarily stopped and Northern Ireland imply UK total unemployed of 3.2 million in 1982-83.]

Very difficult to forecast. Following well-established precedent of previous administrations is not publishing. Public Expenditure White Paper figures are planning assumptions not forecasts.

IF PRESSED that PEWP figures show Government planning sustained higher level of unemployment: No. Maintaining constant figure for the Survey period is conventional assumption adopted by previous Administration. PEWP figures consistent with the prospect of some fall in total unemployment before the end of 1982-83. They do not however necessarily imply this. If things go well - eg lower pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.

6. Employment continuing to fall?

[Total employment declined 1.9 million or 8 per cent in 2 years to Sept 1981. Provisional Q4 figures indicate decline of over 200,000 compared with 150,000 in Q3 and 300,000 per quarter in H1 1981.]

Decline in H2 1981 almost half that in H1. Other labour market indicators improving (see C1, 2 and 4 above).

7. Unemployment higher than in other countries?

[On standardised definitions in 3Q 1981 UK employment was 11½ per cent compared with 6¾ per cent OECD rate; a UK doubling compared with an OECD rise of a third since 1979.]

Whole world affected by rising unemployment. In our case we have additional self inflicted wounds of high pay awards and low productivity. Unemployment now rising very fast in some countries eg Germany.

8. Higher Exchequer costs of unemployment.? Recent Treasury estimates suppressed?

No 'right' figure. Estimates depend critically on assumptions used, the causes of unemployment and items of 'cost' covered. [IF PRESSED: Estimates have been made of cost of additional registered unemployment (eg for 1980-81 in February 1981 EPR). Attempt made to update to 1981-82 - range of figures has been calculated. But doubts expressed about assumptions used. Work, therefore, continues. No decision whether to publish.] Cannot gross up such figures to produce total cost (in terms of lost taxes and extra benefits) of all the unemployed. Meaningless concept. Implies comparison with an economy

with zero unemployment. Can say total expenditure on unemployment and supplementary benefits paid to the unemployed estimated at £4.3 billion in 1981-82 and £5 billion in 1982-83.

9. <u>What is Government doing to provide more jobs?</u>

Illusion to think Government can switch employment off and on like a tap. Government pursuing sensible fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless Government expanding schemes to meet special difficulties and improve training - eg plan to spend £1½ billion in cash on 1982-83 (40 per cent more than in 1981-82) on special employment and training measures; new Youth Training Scheme costing £1 billion a year from 1983-84; and new measure announced in Budget. (See C3).

D TAXATION

1. Burden of taxation

[Total taxation (i.e including for example income tax, indirect taxes, corporation tax,rates and NIC) in 1978-79 was 34½ per cent of GDP (at market prices), 36 per cent in 1979-80, 37½ per cent 1980-81. It is forecast to be 40 per cent in 1981-82 and 39½ per cent in 1982-83.]

This has inevitably increased during a time when the recession has been adding to public spending. Changes proposed in Budget will reduce total burden next year compared with 1981-82. [NB: Not true of burden on persons.]

2. Burden of tax has risen for most households since 1978-79?

[Comparisons given in Parliamentary Answers to Mr Straw 3 December, 17 February and 18 March col W199.]

Slow growth of output and difficulty of restraining public expenditure have inevitably meant higher tax burden. But real personal income after direct taxes still higher than under last Government. And more honest to raise taxes to finance necessary higher expenditure than to increase borrowing, with the increased interest rates and inflation that would bring.

3. Burden has fallen for the rich?

Only because of abolition of absurdly high marginal rates and raising of thresholds in 1979 Budget.

4. Burden has risen most for the poor?

Proportion of income paid in income tax and NICs will <u>fall</u> next year (82-3) for lowest paid taxpayers. And low paid with children entitled to benefits such as FIS.

5. Personal tax burden increased by the recent Budget - when NICs taken into account?

[Full explanation given in Parliamentary Answer 11 March OA col 955].

The real increase in personal allowances and tax thresholds will <u>reduce</u> income tax as a percentage of income at all levels of incomes. [<u>IF PRESSED</u>: In immediate cash terms, increases in personal allowances etc will <u>compensate</u> for NIC increase for <u>majority</u> of taxpayers. Taking into account <u>increased earnings</u> in 1982-83 (for example using the Government Actuary's 7½ per cent assumption) percentage of income paid in income tax <u>plus</u> NIC will <u>rise</u> for most people, but will <u>fall</u> for the lowest paid (below about ½ average earnings (married) and below about 1/3 average earnings (single).] Those over pension age who are taxpayers will benefit from income tax changes and will be unaffected by NIC rise, and, of course, State pensions are being uprated from November .

6. No improvement in incentives?

There will be 1.2 million fewer taxpayers than if allowances had remained at 1981-82 levels, and ½ million fewer higher rate taxpayers. For the substantial number taken out of tax or with reduced marginal rates, incentives will improve.

7. No help on poverty trap?

Numbers in Poverty Trap should not be exaggerated. Increases in income tax allowances have a beneficial impact. [IF PRESSED: overall, small increase in numbers in poverty trap (10,000) as result of FIS uprating. But this helps low paid and generally makes employment more attractive than unemployment.]

8. Reduction in NIS not enough?

Cut welcomed by CBI and industry generally. Provides substantial help on business costs. 1 per cent reduction maximum possible without risks for PSBR: outright abolition too costly. And other measures to help business directly - energy, construction, innnovation and enterprise packages plus helpful - and welcomed - improvements in capital tax regime (see also Section P).

9. Excise duties increases inflationary/harmful to industries

Increases in excise duties as a whole slightly less than broadly compensate for past year's inflation. Variations between duties take account of industrial considerations e.g supplementary increase last July on tobacco/Scotch whisky industry/help for industry by smaller increases on e.g derv - mainly used by industry.

10. Government take from North Sea oil too high?

See S1.

E PUBLIC EXPENDITURE AND FINANCE

[Public Expenditure White Paper (Cmnd 8494) published 9 March. Gives planning totals of £115.2 billion in 1982-83, £121.1 in 1983-84 and £128.4 in 1984-85. About £5 billion higher than last White Paper in 1982-83 and £7 billion in 1983-84. Net effect of changes announced in Budget is to reduce totals to £114.9 billion, £120.4 billion and £127.6 billion].

1. Public expenditure too high?

Spending in 1982-83 planned to be about £5 billion (4½ per cent) lower than intended by last Government even if higher than planned when this Government first took office. Decisions to increase spending represent flexible but prudent response to changed circumstances e.g additional spending to help young unemployed. Drive for to improve management in public sector and reduce administration expenses continues.

2. Ratio of public spending to GDP is getting back to the peak levels of the mid 1970's?

Ratios in 1980-81 (43½ per cent) and 1981-82 (45 per cent forecast) remain below the level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 mainly reflects higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years: assumptions in MTFS would mean figures of 44½ per cent in 1982-83, 42½ per cent in 1983-84 and 41 per cent in 1984-85. Reflects assumed GDP growth and curbing of public expenditure.

3. Cuts in defence spending have weakened our ability to respond to the Falklands crisis?

No. We have not cut defence spending since 1978-79. We have increased it by over 85 per cent in cash terms - a real increase of about 11 per cent - to over £14 billion. We are spending more on conventional naval forces in real terms than was spent in the year before we came to office. When expenditure on modernising the strategic deterrent is at its peak we will still be spending more on the conventional navy than in 1978-79.

4. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term, and would soon lead to more inflation and higher interest rates and inflation. We are responding, within limits of prudence, to needs of current circumstances.

5. Real terms comparisons

No volume equivalents of cash plans. But cash increase in plans between years is 9 per cent in 1982-83, 5 per cent in 1983-84 and 6 per cent in 1984-85 (and projection of GDP deflator in MTFS is rather lower than this in 1982-83, rather higher in 1983-84 and about the same in 1984-85). So in cost terms [i.e cash inflated/deflated by the general movement in prices] there is an increase in 1982-83, a decrease in 1983-84 and a small decrease in 1984-85.

6. Plans unrealistic, given e.g overspending in 1981-82/future rates of inflation?

Total spending in 1981-82 expected to be only a little [NOT FOR USE: 0.4 per cent] higher than planned a year ago. Major reason for overspending is present level of spending by local authorities; this has been taken into account in plans. Realism, particularly in respect of local authorities and nationalised industries, is one reason why plans for future years are higher than in previous White Paper. Large Contingency Reserves due to greater uncertainty in later years and designed to give realistic planning totals.

7. Higher inflation than allowed for in PEWP may raise public spending?

True that inflation assumption in FSBR slightly higher than in PEWP, but:

- for 1982-83 confident that planning total including Contingency Reserve will hold;
- for later years inflation assumption in FSBR a little higher than cost factors used in building up cash programmes;
- in due course, will consider adequacy of cash provision on programmes.

Meantime, uncertainties due to, for example, inflation, are one reason for large Contingency Reserves in later years; makes for realistic planning totals.

8. NIS reduction: effect on public expenditure?

[Programmes will be reduced to reflect reduction in NIS paid by public sector. First estimates of effect (included in post-Budget revised planning totals) is some £360 million in 1982-83 and £450-500 million in later years.]

Government's intention in reducing the NIS is to help private industry, not public sector. Effect of clawback on public sector wil leave its position broadly unchanged. (See also P2).

9. Not enough capital expenditure?

Government prepared to give priority to worthwhile capital projects wherever this can be done within overall spending totals. Plans do allow for changes between 1981-82 and 1982-83 as follows:

- public sector spending on new construction increased by 14 per cent;
- nationalised industries investment to rise by 26 per cent;
- increase in housing investment output [NOTE: if LAs take full advantage of receipts from sales, gross new investment can be as high as £3 billion next year];
- slight increase in work done on water and sewerage projects even though provision reduced).

10. Cuts in capital

Some reductions in cash provision necessary, but recent falls in tender prices (following sharp increases between 1978 and 1980) will mean that programmes mainly affected (roads, water, local environmental services) should be carried out as planned. Planned capital expenditure also reflects decline in needs since early mid-1970s (e.g roads, schools). Planned spending should not jeopardise future standards and availability of public amenities and services.

11. TCSC criticise change to cash planning?

The TCSC do not dispute the decision to change to cash planning. They are concerned rather with the presentation of the figures.

12. Cash planning means concentration on first year, not enough on services in later years?

Government recognise case for medium-term planning. But planning must be related to availability of finance as well as prospective real resources. Cannot accept unconditional commitment to forward plans for services. Volume plans formerly had to be cut when conflicted with financial constraints - e.g after IMF intervention in 1976.

13. Cash figures should be accompanied by constant price figures to give some idea of levels of service?

Constant price figures of limited value in new situation. Cash programmes intended to have primacy. Necessary to get away from old system of "volume planning" and destroy idea that programme managers automatically entitled to be compensated for effects of inflation by revaluing their programmes. In any case old 'volume' figures not a measure of level of service. Simply measured the resources put into programmes - the inputs. The level of service provided - the output - takes account not only of resource inputs, but the efficiency and effectiveness of their use. We are continuing to review and develop the use of output measures in the planning and management of public expenditure.

14. End-year flexibility?

Possibility of end year flexibility is being looked at again. There could be some managerial advantages in such a scheme. But we also have to consider the question of cost.

15. Cash limits 1982-83 and public sector pay?

(See K10-12).

16. Cut public sector pay bill/administrative costs of central government?

Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on. Provision for public service pay increases next year limited to 4 per cent. Administrative costs ae not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain the drive for more efficient management throughout the public sector.

LOCAL GOVERNMENT

17. Overspending in 1982-83?

Too early to say how much local authorities are budgeting above Government plans. But our plans are realistic; local authorities could achieve them (if they wanted to and tried hard enough. [IF PRESSED: Agree that preliminary results disappointing. Government's response will be announced in due course].

18. Government's plans for later years are unattainable?

[Press reports have claimed that White Paper implies 9 per cent total reductions in 1983-84].

Government's plans for 1983-84 are fair and realistic - they are 4 per cent higher than for 1982-83. [IF PRESSED: if this means that LAs are faced with need to make substantial economies, reason will be LA's overspending in 1982-83].

19. Large rate increases this year are Government's fault?

Not at all. If local authorities had sought to spend in line with Government's plans, rate increases should be very low. Where they are high, it is because local authorities have chosen to overspend. [NB. FSBR quotes 12 per cent rise in rate income but this takes account of information so far received on actual rate increases.]

20. Effect of NIS reduction on local authorities?

As Chancellor announced in Budget the lower NIS payments by local authorities will be offset by a reduction in RSG. This will mean that local authorities overall are neither worse nor better as a result of the decrease in NIS. [IF PRESSED: we shall be consulting the local authorities about the details.]

21. Control of rates paid by industry

We certainly share the concern about harmful effect of high rates on business. But, unless local authorities cut their spending, any limit on rates has to be paid for by domestic taxpayer generally. However, we will be considering this further in context of longer term future of domestic rating system. Meanwhile, Government's continuing pressure on local authorities to reduce expenditure should help all ratepayers.

22. Green Paper on Domestic Rating System: Government response?

Government is considering carefully all representations received. We wish to produce proposals for a scheme that will remedy the shortcomings of the present system while commanding wide support.

F CIVIL SERVICE STAFFING AND PAY

[Functions being exercised by HM Treasury since 16 November 1981: (1) civil service manpower, pay and allowances, and superannuation scheme, staff inspection and evaluation, (ie central allocation and control of resources), (2) responsibility for Central Computer and Telecommunication Agency and Civil Service Catering Organisation (3) civil service industrial relations. Functions being exercised by Management and Personnel Office (MPO): (1) civil service efficiency, personnel management, recruitment, retirement policy and training, (2) Office of Parliamentary Counsel (3) machinery of government questions.]

1. Civil Service too big/does too much/is over staffed?

Since the Government came to office, Civil Service has been reduced by nearly 8 per cent to 675,400. This is smallest for 15 years. This results from a reduction in functions, privatisation and improvements in efficiency. We are on course to achieve our aim of having a Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean the smallest Civil Service since the end of the war.

2. Current pay offer to Civil Service

After two negotiating meetings with the non-industrial Civil Service trade unions, no agreement reached. The dispute will be heard (by the Civil Service Arbitration Tribunal) on 19 April.

3. Government offer to Civil Service reasonable?

Basis of the offer is what is needed to recruit, retain and motivate sufficient staff of the right calibre. No justification for asking the taxpayer to do more.

4. Scott Report/Public sector pensions?

See K 18.

G SOCIAL SECURITY

1. Now that unemployment benefit is to be brought into tax why not restore November 1980 5 per cent abatement ?

Decision to abate UB was not simply taken as a proxy for tax but to reduce public expenditure and to improve incentives to find and keep work. (Chancellor's Budget statement in March 1980 made that perfectly clear.) Those reasons remain valid. Any improvement on rates announced would seriously worsen incentives. Cost too would be high - £60 million in a full year [net of reduced claims for supplementary benefit, but gross of tax].

2. Why cut child dependency additions to unemployment benefit?

[In line with practice in recent years, uprated level of child dependency additions to unemployment benefit (but not Supplementary Benefit) has been abated by amount of increase in Child Benefit. In consequence, CDAs will be reduced from current level of 80p to 30p next November.]

The child dependency additions to unemployment benefit are being phased out, and will eventually be replaced entirely by Child Benefit. In this we are following practice adopted by last Labour Government.

3. Increasing supplementary benefits by less than forecast movement of prices hits at poorest of the poor, and breaks an election pledge?

The benefits will retain their value in real terms. Beneficiaries receive not only their scale rate entitlement but a cash payment to cover their housing costs in full. By uprating scale rates in line with RPI which includes housing costs, there has been some double provision. The change corrects that. The abatement of ½ per cent represents a broadly based adjustment for the likely relative movement of housing costs to November 1982. [NOTE: we do not want to make public a forecast of a housing index.]

4. Death grant - increase to realistic level?

[Social Services Secretary announced 10 March intention to publish a consultative document on the death grant.]

Social Services Secretary would welcome comments on his consultative document on death grant which is to be published shortly. As we have always made clear, our aim is to redistribute the resources now devoted to death grant in a more sensible fashion - we cannot afford to add to those resources.

H PUBLIC SECTOR BORROWING

1. PSBR in 1981-82 and 1982-83?

[1982-83 FSBR published 9 March shows an estimated 1981-82 PSBR outturn of £10½ billion and a forecast 1982-83 PSBR of £9½ billion.]

It now looks as though PSBR in 1981-82 will be lower than forecast. Must await publication of PSBR press notice on Thursday 22 April. PSBR in 1982-83 broadly in line with MTFS.

[NOT FOR USE: Provisional outturn figures, available last Thursday, suggest a PSBR for 1981-82 of about £8.7 billion. Main causes of reduction from FSBR were reduced CGBR (£1.2 billion) and reduced LABR (£0.4 billion).]

2. Effect of Civil Service dispute on PSBR?

PSBR in both years affected by Civil Service dispute. In 1981-82 some £¾ billion of receipts delayed from March 1981 were collected but some £1½ billion of receipts due in 1981-82 will now be collected in 1982-83. Debt interest cost of the strike some £½ billion in 1981-82.

3. Why was the 1981-82 CGBR forecast in the FSBR so far out?

[CGBR estimate in FSBR £8.8 billion; April to March press notice £7.6 billion. Main causes of reduction from FSBR were increased taxation receipts (£0.3 billion) and reduced supply expenditure (£0.6 billion).]

Forecast based on best estimates at the time of FSBR. Always difficult to predict flow of expenditure and receipts at the end of the financial year and figures still subject to margin of error. [IF PRESSED: Civil Service dispute affected amount and quality of information available at the time of the FSBR.]

4. Outside forecasters (eg Messels) did better?

Given wide spread of outside forecasts always possible that one will be closer than us. But no forecaster regularly does this.

5. FSBR ESTIMATED 1981-82 CGBR outturn presented artificially high to show declining PSBR between 1981-82 and 1982-83?

Not so. 1981-82 figure was best estimate at time of Budget. [See answer to question 3 above.]

6. What are the implications for the PSBR in 1982-83?

Too early to say in detail. Higher tax revenue in 1981-82 may mean higher revenue from 1982-83 but cannot judge yet whether there are other implications.

7. PSBR should be higher/lower?

PSBR 'broad brush' concept. Main criterion for judging appropriate size is scope for financing it without undue strain on interest.

8. Fiscal policy should be based on cyclically adjusted/real PSBR?

Some merit in inflation-adjusted measure as indicator of fiscal stance in some circumstances. But quite wrong to expand PSBR in cash terms merely to keep inflation-adjusted measure constant. Policies intended to eradicate inflation, not to adjust to it. PSBR has to be formed in the market in real life conditions.

J MONETARY AND FINANCIAL POLICY

1. Effect of Falklands dispute on markets?

[Interest rates have risen by about ½ per cent though as yet no sign of base rate moves. FT industrial ordinary share index down over 20 points.]

Too early to say what long term effects will be, but Government determined not to be deflected from its path. Recent indicators good, eg RPI, money supply figures.

2. Prospects for lower interest rates?

[Bank base rates reduced by ½ per cent to 13 per cent with effect from 12 March. Have come down by 3 per cent from peak of 16 per cent last autumn. Market rates are roughly ½-¾ per cent higher than level just after Budget, largely in reaction to Falklands dispute].

Of course we want to see lower rates. But we must proceed cautiously if we are not to let up in the fight against inflation.

3. Will high and unstable US rates affect UK rates?

[FT 26 March highlighted remarks in BEQB about difficulties posed by rise in US interest rates].

US rates not sole determinant of UK rates, but high US rates certainly an adverse development and in September were a key factor in driving our rates up. Recently, however, sterling has remained reasonably firm, probably helped by improved prospects for wage round, and good trade figures. UK interest rates eased against US trend; but we cannot insulate ourselves from difficult international background.

4. Falls in interest rates since New Year incompatible with strategy?

Taking account of all evidence, present levels of interest rates are consistent with policy of continuing downward pressure on inflation.

5. MTFS being quietly shelved?

[3rd MTFS states Government's objectives 'to reduce inflation and to create conditions for sustainable growth in output and employment', by 'steady but not excessive downward pressure on monetary conditions'. Key financial indicators are the monetary aggregates and exchange rate. Target range for growth of M1, £M3, PSL2 in period February 1982 - April 1983 of 8-12 per cent. Illustrative path of 7-11, 6-10 per cent in 1983-84, 1984-85. Targets for later years to be set nearer the time.]

No. Updated MTFS is realistic and flexible, describes how monetary policy operated in practice. MTFS serves useful purpose. Right to retain and adjust in light of experience.

6. Monetary targets discredited?

Monetary targets have important role in defining medium term direction of policy. But short term movements in monetary aggregates not always reliable guide to monetary conditions. Policy decisions based on assessment of all available evidence.

7. Overshoot of 1981-82 monetary target

[£M3 grew by 0.2 per cent seasonally adjusted in banking March; annual rate of growth since Feb 1981 (ie 1981-82 target period) 13.4 per cent; M1 fell by 0.7 per cent, 7.3 per cent since Feb 1982; PSL 2 rose by 0.6 per cent, 11.7 per cent since Feb 1981.]

Growth in £M3 was above top end of 1981-82 target range, even allowing for effects of Civil Service strike. At least part of excess reflects increasing market share of banks in mortgage lending. Also reflects longer term effects of institutional changes such as ending of corset, abolition of exchange controls and changes in savings behaviour. These factors imply higher monetary growth permissible for same increase in nominal incomes.

8. Monetary conditions too tight?

Behaviour of exchange rate and money GDP as well as monetary aggregates suggest financial conditions have been moderately restrictive as intended. But bank lending still high, despite level of interest rates. Companies' financial position much stronger than a year ago. (See P4)

9. Bank lending

Still very strong. Part at least is substitution for lending by building societies and other forms of consumer credit. To extent that it is additional, adds to inflationary pressure, so must avoid premature relaxation of interest rates.

K PRICES AND EARNINGS

1. Inflation still higher than when Government took office?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 14.1 per cent.]

Average level of inflation will be lower under this Government than under its predecessor. This will be the first Government since the war that has achieved a lower rate of inflation than its predecessor.

2. When will single figure inflation be achieved?

[Year-on-year rate of inflation 11 per cent in February, compared with 21.9 per cent in May 1980 and lowest recent level of 10.9 per cent in July 1981.]

Budget forecast is for year-on-year rate of inflation of 9 per cent by Q4 1982, falling to 7½ per cent by mid-1983.

3. What reason is there to expect a further decline in inflation?

Over the next year or so, moderation in unit labour costs should continue to exert downward pressure on the rate of inflation, as should weak commodity prices. Competitive pressures on firms to limit price rises are also likely to remain strong.

4. FSBR inflation forecast more optimistic than major outside forecasts?

Assessments released since Budget expect single figure inflation to be recorded this year (LBS, NIESR, P&D, Simon and Coats, St James). March CBI monthly trends enquiry showed, for second consecutive month, substantial decline in net balance of firms expecting to raise prices in next four months [Dec and Jan 47 per cent, Feb 40 per cent, March 32 per cent].

5. Effect of 1982 Budget on RPI?

Compared with full indexation of excise duties, direct effect of Budget is RPI reduction of 0.1 per cent (or an increase of 0.1 per cent including also the direct effect of the 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 0.8 per cent increase in the RPI (or 1.4 per cent including also 2 December measures).]

6. Effect of 1982 Budget on TPI?

Compared with full indexation of excise duties, direct effect of Budget is TPI reduction of 0.4 per cent (or increase of 1.1 per cent including also direct effect of 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 1.6 per cent reduction (or a 0.3 per cent increase including also 2 December measures).]

7. Nationalised industry prices

Nationalised industry price rises have been due in part to the ending of the previous Government's policy of artificial and distortionary price restraint. Rate of nationalised industry price rises generally is now coming more closely into line with the RPI. [See R15]

8. Current level of pay settlements?

In economy generally, settlements in last pay round averaged 8-9 per cent. Negotiators seem to be settling up to about a third lower in this round than they did in previous. And almost all settlements seem to be in single figures.

9. Private sector pay - the CBI's 7 per cent?

[CBI figures suggest that manufacturing settlements monitored since 1 August are averaging around 7 per cent.]

Settlements have been lower in recent months, reflecting an increasing sense of realism about pay. But the need is for continuing low settlements which are consistent with maintaining economic recovery and improving employment prospects.

10. Public sector pay

Government's approach to pay in the public services must take account of what the taxpayer can afford. Pay negotiations in the nationalised industries and local authorities are a matter for the parties concerned, as are the financial consequences of any settlements reached.

11. 4 per cent pay factor unrealistic/unfair?

Real incomes had risen to unsustainable level in recent years and public service pay increased relative to private sector since 1979. 4 per cent is broad measure of what Government thinks reasonable and can be afforded as general allowance in fixing the programme from which public service pay bill has to be met.

12. Nurses broken through the 4 per cent?

The 4 per cent factor is not a norm. Government recognises need for pay settlements to take account of market factors, including effect on recruitment and retention of expensively trained staff in NHS.

13. Average earnings index

[Year on year growth 10.8 per cent in January compared with 10.1 per cent in December, though (unpublished) underlying increase slightly less than in previous 5 months at just under 11 per cent.]

Recent buoyancy of earnings partly reflects increase in hours worked, which is an effect of the emerging revival of activity, particularly in manufacturing. Change over the 12 months to January straddles two pay rounds - not useful indicator of recent trends.

14. Comparison of TPI and index shows that real take-home pay has fallen over the past year

Yes. But follows growth of 17½ per cent in personal living standards in three years 1977-80.

15. Movement in TPI

Fact that TPI has been increasing faster than RPI (roughly 3½ per cent faster over year to February 1982) reflects measures taken to restrain Government borrowing -essential if inflation is to be controlled.

16. Government aiming to cut living standards?

[Although RPDI was 1 per cent higher in 1981 Q4 than in 1979 Q1, it is likely to fall below the 1979 Q1 level during 1982]

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

17. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, evasion, administrative cost, and interference with market forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

18. Index-linked pensions and the Scott Report?

The Government is considering the whole question in the light of the Scott Report. Our aim is to ensure that public servants' pensions are fair to taxpayers, as well as to current employees and pensioners and their dependants.

8. Balance of payments Q4 1981

Current account established to have been £1,541 million in surplus in Q4, including a visible trade surplus of £623 million. Total 1981 current account surplus £8 billion.

9. Prospects for 1982?

[FSBR projects surplus of £4 billion on current account; average margin of error is £2 billion. Outside forecasts range from near balance to £7 billion surplus.]

Very uncertain, but nearly all forecasts see continued surplus - albeit below last year's record level.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate

[Since last autumn sterling has remained broadly stable. The average £ effective rate in Q1 1982 was over 10 per cent lower than in Q1 1981. Recent lows were $1.7470 on 6 April, DM 4.07 on 20 October. Highs were $1.97 on 30 November, DM 4.407 on 9 February. Rates at noon on 16 April were $1.7559, DM 4.261 and an effective of 90.0. Reserves at end March stood at $19.0 billion, compared with $23.4 billion under the old valuation at end February.]

The Government has no target for the exchange rate. The rate is taken into account in interpreting domestic monetary conditions and taking decisions on policy.

2. Effects of Falkland Islands on sterling

Hardly surprising if the uncertainties had some unsettling effect. But markets are aware that the underlying position of the UK is strong, with inflation falling, growth picking up and a healthy balance of payments surplus. The Falklands dispute is small in relation to this overall macroeconomic picture, and there is no question of it requiring any change in our basic economic strategy.

3. Bank of England intervening to support the rate?

Policy is unchanged. The Bank do intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions are unsettled. But as the Chancellor has already stated we have no target - undisclosed, secret or otherwise - for the exchange rate.

4. Concerted intervention to reduce the value of the dollar?

All the experience in recent years is that exchange rates for major currencies cannot be manipulated by intervention alone. Intervention can help to steady markets, but not counter major exchange rate trends. That takes changes in real policies, affecting interest rates, monetary conditions and fiscal policies. Lower US inflation is in everyone's interest: the matter for real concern is the US fiscal/interest rate mix, a problem all countries are familiar with.

5 Sterling should join the EMS?

[See N10-11]

6. Lower the exchange rate to help UK competitiveness?

Sterling's effective rate now over 13 per cent below its 1981 peak. But experience of successive devaluations in the UK has shown that attempts to manipulate the exchange rate are no solution to problems in the real economy. Only effective way to gain competitiveness is to control domestic costs in particular wage costs. Any gain in competitiveness achieved by devaluing the currency is simply eroded through higher inflation. Only effective way to gain competitiveness is by bringing costs under control.

7. Why has revaluation of reserves led to such a large fall?

[Revaluation reduced reserves from $23.2 billion to $19.0 billion, a reduction of $4.2 billion.]

Because of the rise in the dollar since March 1981 the value of our non-dollar convertible currency holdings as expressed in dollars is less. At the same time the value of each dollar's worth of reserves is more. Similarly the dollar price of gold has fallen considerably in value over the past year. (Gold held in the reserves (other than that swapped for ecus) has been revalued at 75 per cent of the final fixing price on 31 March, according to the usual formula used in the annual revaluation.)

8. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to $14 billion by end of 1981. This has been more than achieved - external debt is now around $13½ billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. 'Mandate negotiations'

At meeting of Foreign Ministers on 23 March, Presidents of the Commission and Council put forward (on a personal basis) a possible arrangement for future refunds to the UK. Foreign Ministers greeted the proposals with interest, and agreed to study them further at their meeting on 27 April.

2. Link with CAP prices?

All member states agreed that the three chapters of the mandate (development of Community policies, agriculture and the Budget) must be taken together. The agricultural chapter and the budget chapter will therefore be carried forward in parallel.

3. Net UK contribution to community too high?

A lot lower than it would have been without the refund agreement of 30 May 1980.

4. UK refunds in respect of 1981

Commission paid us before 31 March £813 million for supplementary measures as first instalment of our refunds in respect of 1981. This represents 81 per cent of our entitlement for that year. Our net contribution for 1981-82 is now put at some £200 million - very substantially less than it would have been without the 30 May 1980 budget agreement.

5. Lower Commission estimates of net contributions in respect of 1980 and 1981?

Most recent Commission estimates suggest that our net contributions in respect of 1980 and 1981 will be significantly lower than expected at time of 30 May Agreement. That is very satisfactory. For we remain one of the less prosperous Member States.

6. Budget refunds reduced if net contribution less than originally estimated?

The UK is clear that minimum net refunds payable under 30 May agreement are 1175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

7. Do supplementary measures grants lead to additionality?

There is additionality in that refunds enable public expenditure in the regions and elsewhere to be higher than would otherwise have been possible.

8. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

9. Costs of CAP to UK consumers

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

EUROPEAN MONETARY SYSTEM

10. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

11. Join the EMS for exchange rate stability?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

P INDUSTRY

1. Budget does not do enough for industry?

Budget measures directed at helping business and will cost £1 billion in 1982-83. On indexed basis over 2/3 of Budget's net revenue cost will go to help businesses. But main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates.

2. Industry's response to Budget?

[Sir Raymond Pennock, CBI President - 'welcome fillip' to business confidence. Sir Terence Beckett, Director General CBI - 'moves in the right direction'. ABCC - 'insufficient and misconceived'. Saturday 13 March Financial Times Marplan survey of industry's reaction reports 77 per cent thought it 'fairly good' for the economy and half those polled thought would reduce inflation.]

Have noted the Association of British Chambers of Commerce's adverse comments, but pleased with the generally favourable response from industry, including CBI.

3. Prospects for industry-recovery?

Fall in output has now come to an end. Industrial production in Q4 1981 ½ per cent up on Q3 and some 2 per cent up on H1. Budget forecast suggests there may be 3 per cent increase in manufacturing output in 1982 as a whole. March CBI enquiry and FT opinion survey encouraging (see B3).

4. Company financial position?

[Non-oil industrial and commercial companies (ICC's) gross trading profits (net of stock appreciation) rose by over a quarter between 1H and 2H 1981, but from a very low base - ICC's real rate of return just 2½ per cent in 1981. ICC's finances showed some weakening in 4Q reflecting slowdown in destocking and unwinding of civil service dispute, but finances better in 1981 as a whole -

	1980	1981
	£	£
Net borrowing (+) requirement/repayments (-)	+5.7 bn	+4.4 bn
Financial surplus (+)/deficit (-)	- 1½ bn	+1.2 bn]

Increase in profits (albeit from low level) encouraging. Some apparent deterioration in financial position reflects slowdown in rate of destocking, and effects of unwinding of civil service dispute (which delayed companies' tax payments), but companies' finances much healthier in 1981 than year before.

5. <u>Rate of return still too low?</u>

[Real pre-tax rate of return of non-North Sea ICCs rose marginally to $2\frac{1}{2}$ per cent in 1981 Q3 compared to $2\frac{1}{4}$ per cent in Q2 (a record low).]

Yes, but Government can only help in limited ways such as reducing burden of NIS and creating the climate for lower interest rates. Further improvements in ICC's profits and real rates of return can be expected, provided recent productivity gains and trend towards moderate settlements continue.

6. <u>High interest rates damaging for industry and investment?</u>

[Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.]

Budget measures have eased pressure on interest rates, and the recent $\frac{1}{2}$ per cent fall in the banks' base rates is encouraging. But Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Continuing relatively high level of interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFS. (See brief J).

7. <u>Government help for small firms</u>

Budget provided further help for small businesses, increasing the number of measures taken so far to over ninety. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme this year (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

8. <u>Response to Loan Guarantee Scheme?</u>

Scheme operating successfully. We have already issued more than 3,350 guarantees - about half to new businesses. Total lending under scheme is just under £114 million. Budget provided for the lending ceiling - in year to May 1982 - to be raised from £100 million to £150 million. A further £150 million will be made available in following year. Twenty-seven financial institutions are now participating.

9. <u>Progress with setting up Enterprise Zones?</u>

Excellent progress being made. Ten of the eleven zones are already in operation. We expect the final zone - Isle of Dogs - to come into operation towards the end of this month.

1/1

10. Response from private sector?

Response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

R NATIONALISED INDUSTRIES

GOVERNMENT RELATIONS WITH NATIONALISED INDUSTRIES

[Industry Secretary announced 15 March that Government is to change its dealings with nationalised industries by agreeing objectives with each, putting more emphasis on efficiency by increasing Monopolies and Mergers Commission references and through board structures, and by strengthening business expertise in Whitehall.]

1. Whitehall making a take-over bid for the industries?

A distinction needs to be made between monitoring and interference in management. It is crucial for officials and Ministers to be informed about the industries' progress and about any problems that arise; but equally there is no intention to interfere with the proper role of management within the industries.

2. Industries hostile?

Government's proposals have been discussed with the Nationalised Industries Chairman's Group. They support the objectives underlying the proposals and have made a number of constructive comments. But the changes will affect Whitehall as well as the industries.

EXTERNAL FINANCING LIMITS

3. EFLs for 1982-83 and future years?

Nationalised industries' total external finance increased by £1.3 billion in 1982-83, £1.7 billion in 1983-84, £1.2 billion in 1984-85 - a total of over £4 billion over the three years of the Survey. Government has given full recognition to problems faced by the industries in a period of recession. Increase in 1982-83 was roughly half what the industries bid for.

4. Unreasonable to reduce EFLs following NIS cut?

Reduction in the National Insurance Surcharge was designed to benefit private sector; not the intention that public sector should gain from it. Reduction in EFLs will simply offset the addition to the industries' internal resources following the NIS cut. No industries will be worse off than previously, and their plans should be unchanged.

5. Pay assumptions?

Government has not set pay or any other assumptions for the industries. Moderate pay settlements - and restraint of current costs generally - essential if investment programmes to be maintained and prices to consumers kept down.

INVESTMENT

6. How robust are the forecasts of nationalised industry demand/contributions to public expenditure, given the recent track record?

Plans just published are considerably less optimistic than those published last year, when the industries' plans assumed a return to near-total self-financing by 1983-84. In particular, in increasing substantially the external finance available to the industries in each year of the Survey the Government has recognised the effect of lower demand on the industries' internal resources, which are now expected to be well below the levels in last year's White Paper - by about £2 billion in each of the years 1982-83 and 1983-84. The industries' external financing needs are still expected to decline over the Survey period, but from a higher base and at a more gradual rate than forecast last year.

7. Investment plans unlikely to be attained?

No Government can unconditionally guarantee a level of investment by the nationalised industries. Approved levels set out in White Paper are consistent with the industries' agreed external financing requirements, on the basis of the internal resource forecasts they have prepared. But perfectly possible that the plans might need to be revised, for example if the industries fail to restrain their current costs, including pay.

8. But shortfall in capital spending 1981-82?
[Figures in FSBR imply shortfall of £¾ billion.]

Not easy to establish firm reasons after the event. Such evidence as we have suggests a mixture of reasons. Most important has been a cut in investment in response to changed circumstances such as lower market demand. These cuts have been extraneous and have not borne any direct relationship to EFL pressures. Other cuts have been for wholly beneficial reasons, such as lower than expected inflation and cost savings.

9. Take nationalised industry investment out of PSBR?

Real problem of pressure on resources cannot be solved by changing statistical definitions. Since nationalised industries are part of public sector, their borrowing - for whatever purpose - must be definition form part of public sector borrowing requirement.

10. Private finance for NI investment?

[NEDC Working Party's study of nationalised industry investment was discussed at Council's 5 October meeting: agreed there should be review of progress to be completed by June 1982.]

We have indicated our willingness to consider new financing proposals. But direct market finance can only be justified if there is a genuine element of performance-related risk for the investor, in order to improve incentives to management efficiency, and if new forms of saving are tapped, so as to avoid adverse monetary consequences. Market financing does not of itself lessen burden on financial markets.

11. Does the Government propose to sell shares in BT?

[Front page FT Monday 15 March.]

Recent press reports are speculative. As the Chancellor announced in his Budget statement, detailed work is proceeding on the Buzby bond. The Government continues to examine ways in which market pressures could be brought to bear on nationalised industries, including BT.

12. Finance more nationalised industry investment by cutting current spending?

Yes. As in private sector moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries is bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

NATIONALISED INDUSTRY PAY AND PRICES

13. Nationalised industries' prices

Nationalised industries' price rises have been due in part to ending of previous Government's policy of artificial and distortionary price restraint between 1974 and 1980. But since middle of 1980-81, gap between NI price increases and RPI has narrowed. Artificial price restraint would result in unacceptable increased burden on taxpayer and distortion of market forces.

[CAUTION: gap between NI and 'all items' RPI could widen again in near future. Factors include LT fare increases in spring, winter electricity discount scheme ending, dropping out of RPI of last year's double revalorisation of excise duties.]

14. Action in Budget to help industrial energy users?

Total benefit to industry estimated at £150 million in 1982-83 from measures in Budget (combined effect this Budget and last is £250 million over two years 1981-83), namely freeze on industrial gas prices from 1 April to end-1982; new tariff arrangements for largest electricity users (and continuation of arrangements on electricity prices announced last year); standstill till next winter on list prices for foundry coke; extension of boiler conversion grants scheme.

PRIVATISATION

15. What further sales expected?

Special sales of assets in 1982-83 are forecast at around £700 million and around £600 million in each of the later years. These figures are well above those in last White Paper. This reflects primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - which are to be made possible by Oil and Gas (Enterprise) Bill currently before the House.

16. Net figure for special asset sales this year?

[Public Expenditure White Paper showed net sales of only £50 million in 1981-82; latest estimate published in FSBR is -£100 million - ie £100 net purchases.]

The low net figure is the result of decision not to proceed with a further programme of advance oil sales in a weak market. The gross figure expected to be in line with the £500 million target included in the last White Paper, and will include the proceeds from Cable & Wireless, the sale of Amersham International Limited and the National Freight Company Limited, the sale of the Government's shareholding in the British Sugar Corporation, and further sales of motorway service areas long leases.

17. Government simply selling valuable national assets to achieve PSBR target?

Of course the cash is welcome, but benefits run wider than that. Not only will any future borrowing by these undertakings be outside the PSBR, so reducing burden on taxpayers, but the organisations concerned will be made more responsive to market forces and thus have greater incentives to improve efficiency.

18. Government running into heavy weather over sale of Wytch Farm?

The British Gas Corporation is complying with the Government's direction to sell its interest in Wytch Farm. It is too early to say when the sale will take place.

19. Special disposals programme just a subsidy for speculators?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices where shares first traded.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially when company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares.

S NORTH SEA AND UK ECONOMY

1. In view of recent falls in price of oil, why did HMG not reduce tax burden on North Sea oil producers?

[Budget tax changes included abolition of Special Petroleum Duty, increase in Petroleum Revenue Tax rate from 70 per cent to 75 per cent, and new system for advance payments of PRT (all from 1 January 1983), plus smoothing of PRT payments from July 1983 (this improves HMG's cash flow at companies' expense). Changes reduce the marginal rate of tax (from 90.3 to 89.5 per cent); involve slight fall in Government 'take' (no change 1982-83, costs £70 million 1983-84).]

Recognise need for tax structure robust to both falling and rising prices. Detailed study showed us that under new structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that new tax structure will provide more secure and stable regime.

2. Government has missed opportunity to simplify North Sea fiscal regime?

The oil industry has made it clear that it would not welcome a structural upheaval. Would create serious uncertainty and major transitional problems.

3. Impact of falling oil prices on Government revenues and Government strategy?

[PM warned in 23 February speech that limited room for manoeuvre in Budget.]

Other things being equal, lower oil prices will reduce Government revenues from the North Sea. Treasury has estimated that each $1 off the price directly reduces revenue, other things being equal, by £250 million in first year and £350 million in full year. Chancellor warned in his Budget statement he could not rule out possibility of having to take action to correct the fiscal balance if there were to be a marked and prolonged fall in oil prices. But falling world oil prices are good for the world economy. We will benefit from that - not only from impact on activity, but also lower oil prices will help in reducing inflation.

4. Implications of OPEC production limitation agreement for North Sea oil prices?

Remains to be seen whether the agreement will hold, and whether world oil prices will harden as a result.

5. Benefits of North Sea should be used to strengthen the economy?

[FSBR projections (in money of the day) of Government revenues from North Sea: £6.4 billion in 1981-82, £6.2 billion in 1982-83, £6.1 billion in 1983-84, and £8.0 billion in 1984-85. Lower than last year's projections, principally because of downward revision to oil price expectations. Projections already incorporate fall to $31 a barrel for Forties oil. Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise before 1985.]

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

6. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

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

North Sea revenues are already committed. Setting up a special Fund would make no difference. More money would not magically become available. So the money for this Fund would have to come from somewhere else. This would mean higher taxes or lower public expenditure, if public sector borrowing is not to rise. If borrowing did rise, then so would interest rates. Not obvious that net effect would be good for investment.

8. Does HMG endorse conclusions of Bank of England article on North Sea?

[BEQB March issue. Also recent Treasury Working Paper No 22 'North Sea oil and Structural adjustment'.]

Broadly, yes. Useful contribution to debate. Agree that we are better off with oil-at current oil prices - than we would have been without it. We have been spared the fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil is costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for the possession of oil to require a contraction in our industrial base.

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T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Government will have no choice but to reverse policies now unemployment has risen to post-war record levels in many Western countries?

Unadjusted unemployment exceeded 10 million in USA and 1 million in Canada in January. It exceeded 2 million in Italy in September, 2 million in France in October, and 1.9 million in Germany in February. Highest ever unemployment levels in Canada, France, Italy and UK and highest in USA and Germany since the War.]

No indication of a widespread departure from consensus achieved last year (eg Ottawa Summit, IMF Interim Committee) about need for prudent fiscal and monetary policies to bring down inflation.

2. Anti-inflation policies not working?

[Year on year consumer price inflation in major countries fell to 8.5 per cent in February. Underlying rates falling in US. OECD and IMF expect some decline in 1982.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980: some decline expected 1982.

3. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

4. Other countries giving priority to reducing unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

5. Other governments not following such stern policies as UK?

[Most major countries (US, Japan, Germany, Italy, Netherlands, Belgium, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Belgian government has used its special powers to freeze prices temporarily and severely curtail wage increases for rest of 1982.]

Most governments presevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

6. UK is alone in Europe. Even Germany announced investment/employment scheme?

UK far from alone. Almost all European governments working to curb public spending, budget deficits and monetary growth. Netherlands has just agreed to measures which will reduce PSBR by about 0.9 per cent of GDP below what it otherwise would be. French government has set limit on its budget deficit for 1983 of 3 per cent of GDP. German government plans to reduce its borrowing in 1982 Budget even in nominal terms by almost 30 per cent. Unlikely investment/employment scheme will entail any significant increase in borrowing - increase in VAT (by 1 per cent to 14 per cent) part of the package from 1 July next year. Impact on employment remains to be seen.

7. Prospects for UK economy worse than for other countries?

No. Treasury and most independent forecasters expect UK growth this year of about 1½ per cent rising to an annual rate of 2 per cent by early next year. This is very closely in line with the OECD's forecast for OECD Europe. Unemployment is expected to rise in all major countries except Japan. UK inflation (GNP deflators) likely to be around the OECD average and below that in France, Italy and Canada.

8. Prospects for US economy?

[In March US industrial production fell 0.8 per cent, to 8.3 per cent below July's peak; February's rise was shown to be a statistical blip on the chart and on 17 April Treasury Secretary Regan pronounced the economy "dead in the water". Seasonally adjusted unemployment is now 9 per cent of the labour force. Inflation fell for the 5th consecutive month to 7.6 per cent in February.]

Continued decline in inflation is good news; wage settlements in which unions have given job security priority over wage increases are contributing impressively to this decline.

9. US Budget compromise?

[Secretary Regan acknowledged that a Budget compromise was necessary to reduce federal deficits which "will be the signal business wants" (to lower interest rates); White House Chief of Staff James Baker spent much of last week "discussing" possible compromises with Congressional leaders, but the President refuses to "negotiate" until a single Congressional alternative is put to him.]

Firm monetary policy needs to be backed up by tighter fiscal policy. Hope that Congress and Administration soon reach an agreement that will reduce federal deficits and uncertainty in the financial markets. High US interest rates in no-one's interest.

10. Recent international interest rate developments?

True that US interest rates rose earlier this year. But prime rates are well below their peak of 21½ per cent last summer (currently 16½ per cent)

11. Prospects for international interest rates?

Always difficult to force interest rates with certainty, but firm and balanced policies should over a period bring lasting reduction in both inflation and interest rates.

1/2

AIDE MEMOIRE ON THE UK ECONOMY 19 April 1982

PRESENT SITUATION

Clearly a range of outside forecasts; from ITEM and CEPG the more pessimistic to Liverpool more optimistic. Most major post-Budget assessments (LBS, NIESR, St James, P&D, St J) judge impact of Budget and falling oil prices favourable. Output by those groups forecast to grow about 1½ per cent in 1982 (cf FSBR's 1½ per cent), inflation to fall to single figures by end 1982 (cf FSBR's 9 per cent in 4Q 1982); therefore very much in line with FSBR. All groups expect continued rise in unemployment (UK adult sa) during 1982 to around 3 million. Forecasts for 1983 vary, from some groups expecting further rise, to others (P&D, Simon and Coates) expecting some slight decline (roughly 50,000-100,000) and Liverpool expecting fall of 400,000.

GDP output estimate rose in both Q3 and Q4 1981. Level in Q4 some 1 per cent above Q2. Recent months' industrial output figures affected by bad weather, car and rail strikes. Nevertheless, Q4 1981 manufacturing output some 2-3 per cent above low point in Q1 1981.

Consumers' expenditure rose about 1 per cent in Q4 1981: the overall level in 1981 was the same as in both 1980 and 1979. Retail sales in Q1 1982 were over 1 per cent up on the previous 3 months. The volume of visible exports in the last few months of 1981 were high compared with the level earlier in that year but there was a sharp drop in this volatile series in January 1982. Latest evidence indicate that there has been a significant rise in the volume of visible imports since the middle of 1981. DI investment intentions survey conducted in October/November suggests volume of investment, by manufacturing, distributive and service industries (excluding shipping) will rise by about 2 per cent in 1982 following a fall of about 5 per cent in 1981. A large rise is tentatively expected in 1983. Investment by manufacturing (including leasing) is expected to rise during 1982, but for the year as a whole it is likely to be 1 per cent lower than 1981. An appreciable rise is expected in 1983. Manufacturers', wholesalers' and retail stocks dropped by £25 million (at 1975 prices) in Q4 1981 the smallest quarterly fall in the last two years of continuous destocking.

Unemployment (UK, seasonally adjusted excl, school-leavers) was 2,822,500 (11.8 per cent) at March count, up 5,000 on February. Vacancies were 110,600 in March.

Wholesale input prices (fuel and materials) fell 2 per cent in March causing the year-on-year increase to dip to 8 per cent. Wholesale output prices rose ½ per cent in March but fell to 9½ per cent above a year ago. Year on year RPI increase fell to 11.0 per cent in February. Year-on-year increase in average earnings was 10.8 per cent in January. RPDI was flat in

the last three quarters of 1981; it fell 2 per cent between 1980 and 1981 after rising 17 per cent between 1977 and 1980. The savings ratio fell 0.7 points to 13.1 per cent in Q4 1981.

PSBR £9.7 billion in the first three quarters of 1981-82 and CGBR (unadjusted) £7.6 billion in the financial year 1981-2 but both distorted upwards by the civil service dispute.

Sterling M3 and PSL1 both rose 0.2 per cent in banking March while PSL2 rose 0.6 per cent and M1 fell by 0.7 per cent.

Visible trade has showed a surplus of £0.5 billion in the 5 months from September 1981. Current account surplus over same period of £2 billion and likely surplus in 1981 as a whole £8 billion. UK official reserves following revaluation were $19.0 billion at end-March. At the close on 16 April the sterling exchange rate was $1.7635: the effective rate 90.3.

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RESTRICTED

Prime Minister

Dr Bray argued this morning that Treasury Ministers had fiddled with the model, to make it produce these results.

MCS 8/4

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

8 April 1982

M Scholar Esq.
10 Downing Street
LONDON
SW1

Dear Michael,

As you will have seen in the Press, the NEDC discussed yesterday a Treasury paper - produced in response to requests made by the TUC at the Council meeting in January - on various macro-economic simulations carried out by means of the Treasury "model" to test the likely effect of various possible adjustments to economic policy or behaviour. The Chancellor believes that Cabinet colleagues might find this of some background interest, and I attach a copy accordingly.

One of the paper's messages is that the model itself has inescapable limitations and needs to be used with a proper understanding of these, and also with a substantial accompaniment of judgement. This itself is a useful point to get across, especially given the use sometimes made of the model by critics. On the substance of the simulations, the general message is that the kinds of policy relaxation tested - more public spending, less VAT, lower interest rates - all produce only modest short-term benefits which fade away entirely with time and moreover all generate, sooner or later, higher inflation. On the other hand, improvements in economic behaviour - pay restraint, higher productivity - are beneficial in every way. This is another very useful way of bringing home that economic success must depend above all on what industry and work people do, rather than on what Government does.

E1

The discussion in the Council on Tuesday was low key and constructive. Criticism and disagreements were voiced on various aspects of detail, but Mr Murray for the TUC expressed a desire to continue jointly to explore work of this kind to deepen understanding. He did however ask that the paper should not be made available outside in the usual way, largely because (we gathered) he might feel compelled to take a more hostile stance if he had to express reactions in public. The Council accepted accordingly that the document should be formally held back, though it is plain that (probably through NEDO) some press commentators have in fact seen it; and following a request from Dr Jeremy Bray, the Chancellor has agreed that

/it should

it should be available to the Treasury and Civil Service Committee a copy should be placed in the library of the House of Commons.

I am sending copies of this letter, and of the paper, to the Private Secretaries to all Cabinet members, and also to David Wright and Gerry Spence.

Yours ever

Peter

P.S. JENKINS
Private Secretary

PPS/CHANCELLOR

file no TEB/CA/01

copied to:

Mr Salveson (for transmission to No.10)
PS/CST
PS/FST
PS/MST(C)
PS/MST(L)
PS/Home Secretary
PS/Lord Chancellor
PS/Foreign Secretary
PS/Secretary of State for Education and Science
PS/Lord President of the Council
PS/Secretary of State for Northern Ireland
PS/Secretary of State for Defence
PS/Minister of Agriculture, Fisheries and Food
PS/Secretary of State for Environment
PS/Secretary of State for Scotland
PS/Secretary of State for Wales
PS/Lord Privy Seal
PS/Secretary of State for Industry
PS/Secretary of State for Social Services
PS/Secretary of State for Trade
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 29 March, are sidelined.

M M Deyes

M M DEYES

RA

R I G ALLEN

5 April 1982

EB Division
H M Treasury
01-233-3364

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation and promotion of enterprise and initiative. Reduction of inflation requires maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Relative importance given to inflation and unemployment?

Government is concerned about both. These are complementary not competing objectives; unemployment important economic and social problem. But will not be reduced by relaxing struggle against inflation.

3. Effect of lower oil prices?

Very welcome: in some ways like a cut in indirect taxes or NIS supporting recovery and lower inflation. Does reduce room for manoeuvre through fall in Government revenues, but also need for tax reductions. [IF PRESSED on fiscal implications of continued oil price falls: would be of substantial future benefit to inflation and output. As Chancellor said in Budget Speech, wholly irresponsible to rule out possibility of action to adjust fiscal balance.] (See also Section S).

4. Contribution made by 9 March Budget?

Budget continues Government's medium-term strategy for economy. Designed to make further progress on inflation and restore base for economic growth, improved output and increased employment. Tax cuts and other measures designed to help both business and individuals, within responsible fiscal framework.

5. TCSC Report on Budget

[Published 5 April]

Note warm welcome in the Report for one feature of Budget - namely introduction of indexation for taxes on capital. The House will not expect Government to agree ~~to~~ with everything in the Report. [More detailed briefing supplied to Chancellor and copied to No.10.]

6. Reflationary/deflationary/effect on demand?

Oversimple questions. Wrong to talk about what government is 'putting into' or 'taking out' of economy. Ignores links between fiscal and monetary policy and their effects through financial behaviour (interest rates and exchange rate), on economy. Budget's overall effect is to support sustainable recovery.

7. Effects of Budget and December announcements together?

[December announcement provided for £5 billion increase in public expenditure plans for 1982-83 and increased NIC rates yielding £1 billion extra revenue. But total Government revenue in 1982-83 now expected to be some £3½ billion higher than at time of 1981 Budget. Taking account of all these changes, pre-Budget PSBR for 1982-83 about £8¾ billion; post-Budget forecast about £9½ billion.]

No simple answer to this question. So much depends on base one starts from, and what counts as a policy change. Overall effect is reflected in PSBR for 1982-83 a little higher than planned in March 1981. But important thing is continuing decline in PSBR, with benefits for interest rates already apparent, plus substantial cuts in taxation.

8. Not enough help for industry?

Main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates. In addition, specific Budget measures aimed at industry and business will cost about £1 billion in 1982-83. Signs of recovery in profits and financial position of industrial and commercial companies. (See also Section P).

9. Does more for industry than for people?

Help to industry is help to people. Higher allowances and thresholds more than compensate for inflation in last year and make up some of ground lost last year. Many other smaller changes (eg on charities) will help particular groups of people.

10. Another Budget pushing up prices?

No. Changes in excise duties slightly less than required for full revalorisation. 12-monthly inflation rate now 11 per cent (February figure published 19 March) - down from 12 per cent in January. Further fall forecast to 9 per cent by November 1982.

11. Effect of Budget on personal incomes, incentives etc?

See Section D.

12. PSBR for 1981-82 expected to be £1 billion lower than shown in FSBR?

[Report in The Times 5 April]

See Section H.

13. Monetarism dead?

'Monetarism' a much over-used, misused and misunderstood word. Medium-term framework provides essential reference point for policy. Nonsense to suggest MTFS is being slavishly and dogmatically adhered to. Only right to take account of changing circumstances: that is what we have done. But such adjustments do not reflect any weakening in resolve to tackle inflation. Judged by results, policy is succeeding. Inflation has been reduced and is now coming down again.

14. If this is as claimed, a Budget for output, and employment , how many jobs will it create?

Budget forecast shows continuation of recovery; but it is not the practice to publish estimates of the overall effects of the Budget, or its individual measures, on employment or output.

15. Not keeping to commitments to reduce expenditure?

Increases announced in Budget offset by reductions leaving totals still around £115 billion. FSBR shows declining ratio to GDP in future years. (See also Section E).

16. Armstrong/unified Budget?

[TCSC will be questioning Chancellor on this 5 April; further briefing will be supplied if necessary.].

Proposals have wide implications. Need careful consideration. Government does take account of tax and expenditure when taking decisions on each. Await TCSC report with interest.

17. Programmes 'run through Treasury model'

[Paper by Chancellor on various policy simulations using Treasury model to be discussed at NEDC 7 April.]

Use of Treasury model to try to quantify effects of 'Plan for Jobs' (or any other suggested measures) does not of itself guarantee accuracy or confer credibility. Results depend on judgments and assumptions fed in more than 'pressing buttons'.

BULL POINTS

As at 5.4.82 (Tape 455)

(i) Signs of recovery

- Total output (GDP) rose in both 3Q and 4Q 1981. Level in 4Q about 1 per cent above 2Q.
- Short time working in manufacturing fell in 1981 to below ¼ its January peak;
- 1981 figures show volume of engineering and construction orders up about 14 and 10 per cent respectively on 2H 1980.
- Private sector housing starts in 1981 up by 37 per cent on 2H 1980.
- Most recent major independent forecasts assess low point in activity reached in 1H 1981; prospect of some recovery in 1982.

(ii) Earnings and settlements. Increases halved in 1980-81 pay round. Public sector in line. There is a good deal of evidence that average settlements in private sector are running lower than in the 1980-81 round. [CBI pay data bank for manufacturing settlements suggests average is now around 7 per cent compared with 9 per cent in previous round.]

(iii) Manufacturing productivity. Output per head rose 10 per cent during 1981. Output per head and output per person hour now 3½ and 6½ per cent up on previous peak in 1H 1979.

(iv) Unit labour costs: Pay moderation and higher productivity has meant dramatically low increase in manufacturers unit wage costs over last year - just 3¼ per cent in 3 months to January 1982 on a year earlier. Recent rate of increase below the average of our major competitors and comparable to that of Germany and Japan.

(v) Competitiveness. Improved by over 10 per cent during 1981, reflecting pay moderation combined with exchange rate fall.

(vi) Profits: Industrial and commercial companies gross trading profits (excluding N.Sea and net of stock appreciation) rose strongly during 1981, up over 25 per cent between 1H and 2H 1981.

(vii) Exports have held up better than many feared (but low January figures have undermined earlier favourable comparison - non oil exports Sept '81 to Jan '82 up only 1 per cent on 1980). Engineering export orders up 17 per cent in 1981 on 2H 1980 to reach their highest level.

(vii) Unemployment. Rate of increase in unemployment slowed further in 1Q 1982 to just 1/5 that in 4Q 1980. Vacancies improving since mid 1981. Short-time working in manufacturing reduced by over ¾ during 1981 and overtime working has increased.

(ix) Special employment measures. Total provision on Job Release Scheme, Temporary Short-Time Working Compensation and Community Enterprise Programme in 1982-83 now planned to reach over £520 million, with additional £61 million for young worker scheme (starting January 1982). Spending on Youth Opportunities Programme to rise to £700 million in 1982-83. 280,000 unemployed school-leavers last year found places on YOP by Christmas.

(x) Training. Over next 3 years £4 million to be provided to bring training schemes up to date. New Youth Training Scheme for school leavers to be introduced September 183 represents major step towards comprehensive provision for young people.

(xi) Industrial relations. Number of strikes in 1980 and 1981 less than in any year since 1941 and number of working days lost only a third of average of last ten years.

(xii) Retail prices. Inflation halved since peak in spring 1980 (21.9 per cent). 12 monthly increase in February of 11.0 per cent.

(xiii) Share Ownership Schemes: Number of schemes has increased from 30 in May 1979 to over 400. Number of employees covered roughly doubled between first and second years in office. Profit sharing schemes alone now cover some 270 thousand employees.

(xiv) Examples of export successes reported in the Press include: £160 million contract for construction of two new colleges in the largest ever such contract between Britain and Nigeria (Mitchell Cotts Group); and glazing for the new Financial Complex in Port of Spain - the biggest ever such gained by a UK glass processor (Clark and Eaton with Pilkingtons).

(xvii) Overseas investment in UK: US direct investment in Britain amounted to stock of over $14 billion in 1980. Nearly 60 per cent of all US outward non-oil direct investment now takes place in EC - over half of that in UK. Half of all Japanese investment in the EC also comes to Britain.

(xviii) Overseas debt repayments. Official external debt reduced from over $13.3 billion at end-1981.

(xix) Innovation. Total of industrial robots in use in UK reached 713 last year; expected to pass 1000 this summer, UK is fifth in World league table of robot users.

Economic Briefing Division, HM Treasury, 01-233 3819/5809

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent position?

All three GDP measures were higher in real terms in Q4 1981 then had been earlier in year. GDP (output) in Q4 was nearly 1 per cent up on Q2 - the earlier low point.

[IF PRESSED on apparent weakening of recovery (based on November/December/January industrial production) - see 2 below.

2. Recent manufacturing production figures show resumed decline?

[January figures show further fall in industrial and manufacturing production, now 3 and 4 per cent respectively below October levels, with manufacturing production at lowest point since 1967].

Only to be expected that January's index would show some further weakening. Series of factors (car and rail strikes, bad weather, holidays) have distorted the last three months. Despite this, manufacturing output in Q4 1981 some 2-3 per cent higher than its low point earlier in the year (Q1 1981). Preliminary indications for February suggest a pick up, with steel and car output up 16 and 12 per cent respectively, compared with January.

3. Business opinion

March business opinion surveys show encouraging improvement. CBI's monthly enquiry saw further improvement in order books, and rise (to 4 per cent) in net balance of firms expecting to increase output in next four months. FT business opinion survey corroborates this, and shows increased business optimism.

4. Other evidence of improvement in economy?

See Bull Points (following Section A).

5. Government assessment of prospects

[FSBR forecast (9 March) assesses recovery to have begun. Main points are:

	per cent increase on year earlier	
	1982	1983 H1
GDP	1½	2
Manufacturing output	3	2
Consumers expenditure	½	½
Investment (private sector and public corporation)	4½	5
Exports	3½	3

Forecast expects some stockbuilding in 1982, Government expenditure flat.]

FSBR forecast sees prospect of some recovery continuing into 1983. (Last two Government assessments of economy were broadly correct). Healthy rise in private sector investment and exports. Inflation well into single figures (7½ per cent) by mid 1983. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

6. Outside forecasts

[GDP profile in major post-Budget assessments:

	NIESR* (March)	LBS* (March)	St James* (March)	Phillips & Drew (April)	FSBR (Mar)
Per cent change 1982 on 1981	+1½	+1½	+1¼	+1¾	+1½]

Nearly all see prospect of continued recovery in 1982 in line with FSBR, (as always, a range, with Cambridge forecasts being the more pessimistic) and see inflation at 8-9½ per cent by Q4 1982 - also in line with FSBR. [See also C4 (unemployment), K4 (inflation) and L6 (balance of payments).]

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*Submissions to TCSC

C LABOUR MARKET

1. Recent unemployment figures?

[Unemployment (UK adult seasonally adjusted) rose by just 5,000 to 2,823,000 (11.8 per cent) in March. Total unemployment fell by 53,000 to 2,992,000 (12.5 per cent). Average monthly underlying increases in adult unemployment (after allowing for men over 60 transferring to long term Supplementary Benefit) are:

Thousands

1980	1981				1982
Q4	Q1	Q2	Q3	Q4	Q1
105	77	62	51	33	21]

Repetition of February's small increase in adult unemployment seasonally adjusted, encouraging sign that rate of increase slowed markedly further this year.

2. Vacancy figures disappointing?

[Vacancies (UK s.a) fell 2,400 in March to 111,000. Vacancy flow data for February (latest month available) show sharp rise in both inflow and outflow.]

Not too much should be made of one month's figures. Vacancies have been rising since middle of last year, and flow (ie vacancy turnover) has improved steadily.

3. Effect of Budget on unemployment?

Budget contributes to Government strategy of fostering conditions for sustainable growth. Help to business will lay foundation for more real jobs. Employment will benefit from some further improvement in activity. Proposed new non-profit-making scheme will enable local authorities and voluntary sponsors to provide many new jobs. (MSC to advise what possible: for illustration, Government prepared finance 100,000 at net additional Exchequer cost of £150 million).

4. Unemployment expected to continue rising rapidly?

[Outside forecasters see continued rise in registered unemployment during 1982 reaching about 3 million (UK adults) in Q4. Opinion divided for 1983, some pre-Budget forecasts (CEPG, Cambridge Econometrics, ITEM, NIESR) see rise continuing but at a slower rate, others broadly flat (LBS, St James); only Liverpool foresee a fall (400,000). Some post-Budget forecasts (P&D, S & Coats) expect slight (roughly 50-100,000) fall in 1983.]

Unemployment forecasts uncertain; independent forecasters encompass differing views for 1983 - several projecting stabilisation, some a [slight] decline. Rise in unemployment drastically reduced since end 1980. Clear evidence of further slowing down this year - Q1 1982 rise just 1/5 that in Q4 1980. Vacancies, short time and overtime all improved last year. Employment situation will benefit from some further recovery in activity this year.

5. Government forecasts for unemployment

[1982 PEWP uses working assumption of an average level of 2.9 million unemployed in Great Britain (excluding school leavers) in 1982-83 and rest of survey period. School leavers, adult students, temporarily stopped and Northern Ireland imply UK total unemployed of 3.2 million in 1982-83.]

Very difficult to forecast. Following well-established precedent of previous administrations is not publishing. Public Expenditure White Paper figures are planning assumptions not forecasts.

IF PRESSED that PEWP figures show Government planning sustained higher level of unemployment: No. Maintaining constant figure for the Survey period is conventional assumption adopted by previous Administration. PEWP figures consistent with the prospect of some fall in total unemployment before the end of 1982-83. They do not however necessarily imply this. If things go well - eg lower pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.

6. Employment continuing to fall?

[Total employment declined 1.9 million or 8 per cent in 2 years to Sept 1981. Provisional Q4 figures indicate decline of over 200,000 compared with 150,000 in Q3 and 300,000 per quarter in H1 1981.]

Decline in H2 1981 almost half that in H1. Other labour market indicators improving (see C1, 2 and 4 above).

7. Unemployment higher than in other countries?

[On standardised definitions in 3Q 1981 UK employment was 11½ per cent compared with 6¾ per cent OECD rate; a UK doubling compared with an OECD rise of a third since 1979.]

Whole world affected by rising unemployment. In our case we have additional self inflicted wounds of high pay awards and low productivity. Unemployment now rising very fast in some countries eg Germany.

8. Higher Exchequer costs of unemployment.? Recent Treasury estimates suppressed?

No 'right' figure. Estimates depend critically on assumptions used, the causes of unemployment and items of 'cost' covered. [IF PRESSED: Estimates have been made of cost of additional registered unemployment (eg for 1980-81 in February 1981 EPR). Attempt made to update to 1981-82 - range of figures has been calculated. But doubts expressed about assumptions used. Work, therefore, continues. No decision whether to publish.] Cannot gross up such figures to produce total cost (in terms of lost taxes and extra benefits) of all the unemployed. Meaningless concept. Implies comparison with an economy

with zero unemployment. Can say total expenditure on unemployment and supplementary benefits paid to the unemployed estimated at £4.3 billion in 1981-82 and £5 billion in 1982-83.

9. What is Government doing to provide more jobs?

Illusion to think Government can switch employment off and on like a tap. Government pursuing sensible fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless Government expanding schemes to meet special difficulties and improve training - eg plan to spend £1½ billion in cash on 1982-83 (40 per cent more than in 1981-82) on special employment and training measures; new Youth Training Scheme costing £1 billion a year from 1983-84; and new measure announced in Budget. (See C3).

D TAXATION

1. Burden of taxation

[Total taxation (i.e including for example income tax, indirect taxes, corporation tax,rates and NIC) in 1978-79 was 34½ per cent of GDP (at market prices), 36 per cent in 1979-80, 37½ per cent 1980-81. It is forecast to be 40 per cent in 1981-82 and 39½ per cent in 1982-83.]

This has inevitably increased during a time when the recession has been adding to public spending. Changes proposed in Budget will reduce total burden next year compared with 1981-82. [NOT FOR USE: not necessarily true of burden on persons.]

2. Burden of tax has risen for most households since 1978-79?

[Comparisons given in Parliamentary Answers to Mr Straw 3 December, 17 February and 18 March col W199.]

Slow growth of output and difficulty of restraining public expenditure have inevitably meant higher tax burden. But real personal income after direct taxes still higher than under last Government. And more honest to raise taxes to finance necessary higher expenditure than to increase borrowing, with the increased interest rates and inflation that would bring.

3. Burden has fallen for the rich?

Only because of abolition of absurdly high marginal rates and raising of thresholds in 1979 Budget.

4. Burden has risen most for the poor?

Proportion of income paid in income tax and NICs will fall next year (82-3) for lowest paid taxpayers. And low paid with children entitled to benefits such as FIS.

5. Personal tax burden increased by the recent Budget - when NICs taken into account?

[Full explanation given in Parliamentary Answer 11 March OA col 955].

The real increase in personal allowances and tax thresholds will reduce income tax as a percentage of income at all levels of incomes. [IF PRESSED: In immediate cash terms, increases in personal allowances etc will compensate for NIC increase for majority of taxpayers. Taking into account increased earnings in 1982-83 (for example using the Government Actuary's 7½ per cent assumption) percentage of income paid in income tax plus NIC will rise for most people, but will fall for the lowest paid (below about ½ average earnings (married) and below about 1/3 average earnings (single).] Those over pension age who are taxpayers will benefit from income tax changes and will be unaffected by NIC rise, and, of course, State pensions are being uprated from November (~~[illegible]~~).

6. No improvement in incentives?

There will be 1.2 million fewer taxpayers than if allowances had remained at 1981-82 levels, and ½ million fewer higher rate taxpayers. For the substantial number taken out of tax or with reduced marginal rates, incentives will improve.

7. No help on poverty trap?

Numbers in Poverty Trap should not be exaggerated. Increases in income tax allowances have a beneficial impact. [IF PRESSED: overall, small increase in numbers in poverty trap (10,000) as result of FIS uprating. But this helps low paid and generally makes employment more attractive than unemployment.]

8. Reduction in NIS not enough?

Cut welcomed by CBI and industry generally. Provides substantial help on business costs. 1 per cent reduction maximum possible without risks for PSBR: outright abolition too costly. And other measures to help business directly - energy, construction, innnovation and enterprise packages plus helpful - and welcomed - improvements in capital tax regime (see also Section P).

9. Excise duties increases inflationary/harmful to industries

Increases in excise duties as a whole slightly less than broadly compensate for past year's inflation. Variations between duties take account of industrial considerations e.g supplementary increase last July on tobacco/Scotch whisky industry/help for industry by smaller increases on e.g derv - mainly used by industry.

10. Petrol/derv/VED increases anti-motorist/industry?

These three duties not singled out; increases as a whole no more than broadly compensate for past year's inflation. 2p smaller increase on derv further shields industry and distribution costs by increasing differential with petrol (10p a gallon) introduced last July.

11. Why no VAT relief for charities?

Not possible: high revenue cost; serious definitional and administrative difficulties; would have repercussions in other areas, which could seriously erode VAT revenue base.

12. Not enough to encourage (existing) small firms?

Substantial measures in enterprise package - full year cost about £80 million. (see also P7-8). Many of latest measures (e.g increase in 'small companies' Corporation Tax profits limits, VAT registration thresholds, purchase of own shares) benefit existing small businesses.

13. Government take from North Sea oil too high?

See S1.

14. Imposition of VAT on gold coins?

Necessary to prevent risk of substantial fraud running into tens of millions of £s a year. [Recent case sub judice.] Vast majority of these coins bought for investment purposes, and many other investment items (eg antiques) already bear VAT. No evidence that will lead to large scale diversion of trade abroad.

E PUBLIC EXPENDITURE AND FINANCE

[Public Expenditure White Paper (Cmnd 8494) published 9 March. Gives planning totals of £115.2 billion in 1982-83, £121.1 in 1983-84 and £128.4 in 1984-85. About £5 billion higher than last White Paper in 1982-83 and £7 billion in 1983-84. Net effect of changes announced in Budget is to reduce totals to £114.9 billion, £120.4 billion and £127.6 billion].

1. Public expenditure too high?

Spending in 1982-83 planned to be about £5 billion (4½ per cent) lower than intended by last Government even if higher than planned when this Government first took office. Decisions to increase spending represent flexible but prudent response to changed circumstances e.g additional spending to help young unemployed. Drive for to improve management in public sector and reduce administration expenses continues.

2. Ratio of public spending to GDP is getting back to the peak levels of the mid 1970's?

Ratios in 1980-81 (43½ per cent) and 1981-82 (45 per cent forecast) remain below the level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 mainly reflects higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years: assumptions in MTFS would mean figures of 44½ per cent in 1982-83, 42½ per cent in 1983-84 and 41 per cent in 1984-85. Reflects assumed GDP growth and curbing of public expenditure.

3. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term, and would soon lead to more inflation and higher interest rates and inflation. We are responding, within limits of prudence, to needs of current circumstances.

4. Real terms comparisons

No volume equivalents of cash plans. But cash increase in plans between years is 9 per cent in 1982-83, 5 per cent in 1983-84 and 6 per cent in 1984-85 (and projection of GDP deflator in MTFS is rather lower than this in 1982-83, rather higher in 1983-84 and about the same in 1984-85). So in cost terms [i.e cash inflated/deflated by the general movement in prices] there is an increase in 1982-83, a decrease in 1983-84 and a small decrease in 1984-85.

5. Plans unrealistic, given e.g overspending in 1981-82/future rates of inflation?

Total spending in 1981-82 expected to be only a little [NOT FOR USE: 0.4 per cent] higher than planned a year ago. Major reason for overspending is present level of spending by local authorities; this has been taken into account in plans. Realism, particularly in respect of local authorities and nationalised industries, is one reason why plans for future years are higher than in previous White Paper. Large Contingency Reserves due to greater uncertainty in later years and designed to give realistic planning totals.

6. Higher inflation than allowed for in PEWP may raise public spending?

True that inflation assumption in FSBR slightly higher than in PEWP, but:

- for 1982-83 confident that planning total including Contingency Reserve will hold;
- for later years inflation assumption in FSBR a little higher than cost factors used in building up cash programmes;
- in due course, will consider adequacy of cash provision on programmes.

Meantime, uncertainties due to, for example, inflation, are one reason for large Contingency Reserves in later years; makes for realistic planning totals.

7. NIS reduction: effect on public expenditure?

[Programmes will be reduced to reflect reduction in NIS paid by public sector. First estimates of effect (included in post-Budget revised planning totals) is some £360 million in 1982-83 and £450-500 million in later years.]

Government's intention in reducing the NIS is to help private industry, not public sector. Effect of clawback on public sector wil leave its position broadly unchanged. (See also P2).

8. Not enough capital expenditure?

Government prepared to give priority to worthwhile capital projects wherever this can be done within overall spending totals. Plans do allow for changes between 1981-82 and 1982-83 as follows:

- public sector spending on new construction increased by 14 per cent;
- nationalised industries investment to rise by 26 per cent;
- increase in housing investment output [NOTE: if LAs take full advantage of receipts from sales, gross new investment can be as high as £3 billion next year];
- slight increase in work done on water and sewerage projects even though provision reduced).

9. Cuts in capital

Some reductions in cash provision necessary, but recent falls in tender prices (following sharp increases between 1978 and 1980) will mean that programmes mainly affected (roads, water, local environmental services) should be carried out as planned. Planned capital expenditure also reflects decline in needs since early mid-1970s (e.g roads, schools). Planned spending should not jeopardise future standards and availability of public amenities and services.

10. Cash planning means concentration on first year, not enough on services in later years?

[No going back to volume planning : Sir Anthony Rawlinson at TCSC 31 Mar]

Government recognise case for medium-term planning. But planning must be related to availability of finance as well as prospective real resources. Cannot accept unconditional commitment to forward plans for services. Volume plans formerly had to be cut when conflicted with financial constraints - e.g after IMF intervention in 1976.

11. End-year flexibility?

Possibility of end year flexibility is being looked at again. There could be some managerial advantages in such a scheme. But we also have to consider the question of cost.

12. Cash limits 1982-83 and public sector pay?

(See K10-12).

13. Cut public sector pay bill/administrative costs of central government?

Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on. Provision for public service pay increases next year limited to 4 per cent. Administrative costs ae not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain the drive for more efficient management throughout the public sector.

LOCAL GOVERNMENT

14. Overspending in 1982-83?

Too early to say how much local authorities are budgeting above Government plans. But our plans are realistic; local authorities could achieve them (if they wanted to and tried hard enough. [IF PRESSED: Agree that preliminary results disappointing. Government's response will be announced in due course].

15. Government's plans for later years are unattainable?

[Press reports have claimed that White Paper implies 9 per cent total reductions in 1983-84].

Government's plans for 1983-84 are fair and realistic - they are 4 per cent higher than for 1982-83. [IF PRESSED: if this means that LAs are faced with need to make substantial economies, reason will be LA's overspending in 1982-83].

16. Large rate increases this year are Government's fault?

Not at all. If local authorities budget to spend in line with Government's plans, rate increases should be very low. Where they are high, it is because local authorities have chosen to overspend. [NB. FSBR quotes 12 per cent rise in rate income but this takes account of information so far received on actual rate increases.]

17. Effect of NIS reduction on local authorities?

As Chancellor announced in Budget the lower NIS payments by local authorities will be offset by a reduction in RSG. This will mean that local authorities overall are neither worse nor better as a result of the decrease in NIS. [IF PRESSED: we shall be consulting the local authorities about the details.]

18. Control of rates paid by industry

We certainly share the concern about harmful effect of high rates on business. But, unless local authorities cut their spending, any limit on rates has to be paid for by domestic taxpayer generally. However, we will be considering this further in context of longer term future of domestic rating system. Meanwhile, Government's continuing pressure on local authorities to reduce expenditure should help all ratepayers.

19. Green Paper on Domestic Rating System: Government response?

Government is considering carefully all representations received. We wish to produce proposals for a scheme that will remedy the shortcomings of the present system while commanding wide support.

F CIVIL SERVICE STAFFING AND PAY

[Functions being exercised by HM Treasury since 16 November 1981: (1) civil service manpower, pay and allowances, retirement policy and superannuation scheme, staff inspection and evaluation, (ie central allocation and control of resources), (2) responsibility for Central Computer and Telecommunication Agency and Civil Service Catering Organisation (3) civil service industrial relations. Functions being exercised by Management and Personnel Office (MPO): (1) civil service efficiency, personnel management, recruitment and training, (2) Office of Parliamentary Counsel (3) machinery of government questions.]

1. <u>Civil Service too big/does too much/is over staffed?</u>

Since the Government came to office, Civil Service has been reduced by nearly 8 per cent to 675,400. This is smallest for 15 years. This results from a reduction in functions, privatisation and improvements in efficiency. We are on course to achieve our aim of having a Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean the smallest Civil Service since the end of the war.

2. <u>Current pay offer to Civil Service</u>

After two negotiating meetings with the non-industrial Civil Service trade unions, no agreement reached. The dispute will be heard (by the Civil Service Arbitration Tribunal) on 19 April.

3. <u>Government offer to Civil Service reasonable?</u>

Basis of the offer is what is needed to recruit, retain and motivate sufficient staff of the right calibre. No justification for asking the taxpayer to do more.

4. <u>Scott Report/Public sector pensions?</u>

See K 18.

G SOCIAL SECURITY

1. Now that unemployment benefit is to be brought into tax why not restore November 1980 5 per cent abatement ?

Decision to abate UB was not simply taken as a proxy for tax but to reduce public expenditure and to improve incentives to find and keep work. (Chancellor's Budget statement in March 1980 made that perfectly clear.) Those reasons remain valid. Any improvement on rates announced would seriously worsen incentives. Cost too would be high - £60 million in a full year [net of reduced claims for supplementary benefit, but gross of tax].

2. Why cut child dependency additions to unemployment benefit?

[In line with practice in recent years, uprated level of child dependency additions to unemployment benefit (but not Supplementary Benefit) has been abated by amount of increase in Child Benefit. In consequence, CDAs will be reduced from current level of 80p to 30p next November.]

The child dependency additions to unemployment benefit are being phased out, and will eventually be replaced entirely by Child Benefit. In this we are following practice adopted by last Labour Government.

3. Increasing supplementary benefits by less than forecast movement of prices hits at poorest of the poor, and breaks an election pledge?

The benefits will retain their value in real terms. Beneficiaries receive not only their scale rate entitlement but a cash payment to cover their housing costs in full. By uprating scale rates in line with RPI which includes housing costs, there has been some double provision. The change corrects that. The abatement of ½ per cent represents a broadly based adjustment for the likely relative movement of housing costs to November 1982. [NOTE: we do not want to make public a forecast of a housing index.]

4. Death grant - increase to realistic level?

[Social Services Secretary announced 10 March intention to publish a consultative document on the death grant.]

Social Services Secretary would welcome comments on his consultative document on death grant which is to be published shortly. As we have always made clear, our aim is to redistribute the resources now devoted to death grant in a more sensible fashion - we cannot afford to add to those resources.

H PUBLIC SECTOR BORROWING

1. PSBR in 1981-82 and 1982-83

[1982-83 FSBR published 9 March shows an estimated 1981-82 PSBR outturn of £10½ billion, and a forecast 1982-83 PSBR of £9½ billion.]

It now looks as though PSBR in 1981-82 ~~in line with~~ could be lower than 1981 Budget forecast, ~~and~~ PSBR ~~reduction~~ in 1982-83 broadly in line with 1981 MTFS (see questions 3 and 4 below)

2. Effect of Civil Service dispute on PSBR?

PSBR in both years affected by Civil Service dispute. In 1981-82 some £¾ billion of receipts delayed from March 1981 were collected but some £1 billion of receipts due in 1981-82 will now be collected in 1982-83. Debt interest cost of the strike some £½ billion in 1981-82.

3. CGBR outturn for 1981-82 much lower than in FSBR (Monday's report in The Times)?

[CGBR estimate in FSBR £8.75 billion; April-February (published) £8.1 billion.]

[NOT FOR USE. Provisional outturn figures, available last Friday, show CGBR as £7.6 billion; main causes of reduction from FSBR were increased taxation receipts (£0.3 billion) and reduced supply expenditure (£0.6 billion)].

Borrowing figures in FSBR were consistent with outturn information available at that time. Now seems likely that CGBR for 1981-82 will fall short of outturn estimated in FSBR. Must ask hon members to await publication of CGBR press notice on Tuesday April 13 for further details. [IF PRESSED: Too soon yet to have established reliably the causes of the shortfall e.g post Civil Service strike effects.]

4. Government seeking credit for fall in PSBR from year to year by over-stating likely 1981-82 outturn?

No. £10½ billion was the best estimate for 1981-82 PSBR at time of FSBR. CGBR may not now be as high as expected at time of FSBR, but must await further information on other components. Normally a surge in borrowing in last quarter of financial year (LA's borrowing, other spending up).

[NOT FOR USE: Provisional figures to end February suggest that the local authority and public corporation figures may also be low. First estimates on preliminary data should be available around 14-15 April for publication on 22 April].

5. PSBR should be higher/lower?

The PSBR reduction in 1982-83 is broadly in line with 1981 MTFS. [IF PRESSED: PSBR 'broad brush' concept. Cannot adjust for every factor. Swings and roundabouts. Main criterion for judging appropriate size is scope for financing it without undue strain on interest rates.]

6. Fiscal policy should be based on cyclically adjusted/real PSBR?

Some merit in inflation-adjusted measure as indicator of fiscal stance in some circumstances. But there are dangers here: it would be quite wrong to expand PSBR in cash terms in response to an upsurge in inflation merely to keep inflation-adjusted measure constant. Policies intended to eradicate inflation, not to adjust to it.

J MONETARY AND FINANCIAL POLICY

[Separate briefing will be provided to No.10 on Tuesday's money supply figures]

1. Lower interest rates?

[Bank base rates reduced by ½ per cent to 13 per cent with effect from 12 March. Have come down by 3 per cent from peak of 16 per cent last autumn. Market rates have eased slightly in recent days but remain consistent with base rates at 13 per cent].

Of course we want to see lower rates. But we must proceed cautiously if we are not to let up in the fight against inflation. Despite difficult conditions abroad, interest rates have fallen.

2. Will high and unstable US rates affect UK rates?

[FT 26 March highlighted remarks in BEQB about difficulties posed by rise in US interest rates].

US rates not sole determinant of UK rates, but high US rates certainly an adverse development and in September were a key factor in driving our rates up. Recently, however, sterling has remained reasonably firm, probably helped by improved prospects for wage round, and good trade figures. UK interest rates eased against US trend; but we cannot insulate ourselves from difficult international background.

3. Recent fall in interest rates incompatible with strategy

Taking account of all evidence, present levels of interest rates are consistent with policy of continuing downward pressure on inflation.

4. MTFS being quietly shelved?

[3rd MTFS states Government's objectives 'to reduce inflation and to create conditions for sustainable growth in output and employment', by 'steady but not excessive downward pressure on monetary conditions'. Key financial indicators are the monetary aggregates and exchange rate. Target range for growth of M1, £M3, PSL2 in period February 1982 - April 1983 of 8-12 per cent. Illustrative path of 7-11, 6-10 per cent in 1983-84, 1984-85. Targets for later years to be set nearer the time.]

No. Updated MTFS is realistic and flexible, describes how monetary policy operated in practice. MTFS serves useful purpose. Right to retain and adjust in light of experience.

5. Monetary targets discredited?

Monetary targets have important role in defining medium term direction of policy. But short term movements in monetary aggregates not always reliable guide to monetary conditions. Policy decisions based on assessment of all available evidence.

6. Increase in target ranges

Ranges in past MTFS were purely illustrative. Did not take account of structural changes. Right to take account of current rate of growth in setting new targets, to avoid unduly sharp brake on monetary growth. 8-12 per cent still implies deceleration from current growth rate ie continued downward pressure on monetary growth.

7. What if aggregates' rates of growth diverge?

Will examine factors underlying divergence. Policy decisions will continue to take account of all available evidence with a view to restraining inflationary pressures.

8. Overshoot of 1981-82 target

[£M3 was little changed during banking February; rate of growth over past 12 months (ie the target period) was 14.4 per cent. M1 fell by about ½ per cent in banking February; grew by 8.7 per cent over past 12 months; PSL2 rose by about ½ per cent in banking February; grew by 12.1 per cent over 12 months.]

Growth in £M3 was above top end of target range, even allowing for effects of Civil Service strike. At least part of excess reflects increasing market share of banks in mortgage lending. Also reflects longer term effects of institutional changes such as ending of corset, abolition of exchange controls and changes in savings behaviour. These factors imply higher monetary growth permissible for same increase in nominal incomes.

9. Monetary conditions too tight?

Behaviour of exchange rate and money GDP as well as monetary aggregates suggest financial conditions have been moderately restrictive as intended. But bank lending still high, despite level of interest rates. Companies' financial position much stronger than a year ago. (See P4)

10. Bank lending

Still very strong. Part at least is substitution for lending by building societies and other forms of consumer credit. To extent that it is additional, adds to inflationary pressure, so must avoid premature relaxation of interest rates.

K PRICES AND EARNINGS

1. Inflation still higher than when Government took office?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 14.1 per cent.]

Average level of inflation will be lower under this Government than under its predecessor. This will be the first Government since the war that has achieved a lower rate of inflation than its predecessor.

2. When will single figure inflation be achieved?

[Year-on-year rate of inflation 11 per cent in February, compared with 21.9 per cent in May 1980 and lowest recent level of 10.9 per cent in July 1981.]

Budget forecast is for year-on-year rate of inflation of 9 per cent by Q4 1982, falling to 7½ per cent by mid-1983.

3. What reason is there to expect a further decline in inflation?

Over the next year or so, moderation in unit labour costs should continue to exert downward pressure on the rate of inflation, as should weak commodity prices. Competitive pressures on firms to limit price rises are also likely to remain strong.

4. FSBR inflation forecast more optimistic than major outside forecasts?

Assessments released since Budget expect single figure inflation to be recorded this year (LBS, NIESR, P&D, Simon and Coats, St James). March CBI monthly trends enquiry showed, for second consecutive month, substantial decline in net balance of firms expecting to raise prices in next four months [Dec and Jan 47 per cent, Feb 40 per cent, March 32 per cent].

5. Effect of 1982 Budget on RPI?

Compared with full indexation of excise duties, direct effect of Budget is RPI reduction of 0.1 per cent (or an increase of 0.1 per cent including also the direct effect of the 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 0.8 per cent increase in the RPI (or 1.4 per cent including also 2 December measures).]

6. Effect of 1982 Budget on TPI?

Compared with full indexation of excise duties, direct effect of Budget is TPI reduction of 0.4 per cent (or increase of 1.1 per cent including also direct effect of 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 1.6 per cent reduction (or a 0.3 per cent increase including also 2 December measures).]

7. Nationalised industry prices

Nationalised industry price rises have been due in part to the ending of the previous Government's policy of artificial and distortionary price restraint. Rate of nationalised industry price rises generally is now coming more closely into line with the RPI. [See R15]

8. Current level of pay settlements?

In economy generally, settlements in last pay round averaged 8-9 per cent. Negotiators seem to be settling up to about a third lower in this round than they did in previous. And almost all settlements seem to be in single figures.

9. Private sector pay - the CBI's 7 per cent?

[CBI figures suggest that manufacturing settlements monitored since 1 August are averaging around 7 per cent.]

Settlements have been lower in recent months, reflecting an increasing sense of realism about pay. But the need is for continuing low settlements which are consistent with maintaining economic recovery and improving employment prospects.

10. Public sector pay

Government's approach to pay in the public services must take account of what the taxpayer can afford. Pay negotiations in the nationalised industries and local authorities are a matter for the parties concerned, as are the financial consequences of any settlements reached.

11. 4 per cent pay factor unrealistic/unfair?

Real incomes had risen to unsustainable level in recent years and public service pay increased relative to private sector since 1979. 4 per cent is broad measure of what Government thinks reasonable and can be afforded as general allowance in fixing the programme from which public service pay bill has to be met.

12. Nurses broken through the 4 per cent?

The 4 per cent factor is not a norm. Government recognises need for pay settlements to take account of market factors, including effect on recruitment and retention of expensively trained staff in NHS.

13. Average earnings index

[Year on year growth 10.8 per cent in January compared with 10.1 per cent in December , though (unpublished) underlying increase slightly less than in previous 5 months at just under 11 per cent.]

Recent buoyancy of earnings partly reflects increase in hours worked, which is an effect of the emerging revival of activity, particularly in manufacturing. Change over the 12 months to January straddles two pay rounds - not useful indicator of recent trends.

14. Comparison of TPI and index shows that real take-home pay has fallen over the past year

Yes. But follows growth of 17½ per cent in personal living standards in three years 1977-80.

15. Movement in TPI

Fact that TPI has been increasing faster than RPI (roughly 3½ per cent faster over year to February 1982) reflects measures taken to restrain Government borrowing -essential if inflation is to be controlled.

16. Government aiming to cut living standards?

[2 per cent fall in RPDI during 1981 - concentrated in Q2]

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

17. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, evasion, administrative cost, and interference with market forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

18. Index-linked pensions and the Scott Report?

The Government is considering the whole question in the light of the Scott Report. Our aim is to ensure that public servants' pensions are fair to taxpayers, as well as to current employees and pensioners and their dependants.

L. BALANCE OF PAYMENTS

1. January trade figures

[Published 2 April]

Current account surplus in January estimated at £348 million, continuing the trend of strong surpluses. A visible trade deficit of £132 million was outweighed by projected invisible surplus of £480 million, swollen by EC budget refunds.

2. Exports

January export figures were erratically low, probably due to bad weather during first half of month. Necessary to wait for February figures for more accurate idea of recent export trends.

3. Imports

January import figures tend to confirm trend of last quarter 1981, reflecting increased demand for basic materials and other imports ~~up~~ together with much less destocking.

4. Why is invisible surplus projection so high?

The projected invisibles surplus of £480 million takes into account further EC budget refunds of over £800 million in Q1 1982 (see N4). Earnings of overseas oil companies operating in the North Sea are likely to have been depressed, reducing debits on the interest, profit and dividends account.

5. Balance of payments Q4 1981

Current account established to have been £1,541 million in surplus in Q4, including a visible trade surplus of £623 million. Total 1981 current account surplus £8 billion.

6. Prospects for 1982?

[FSBR projects surplus of £4 billion on current account; average margin of error is £2 billion. Outside forecasts range from near balance to £7 billion surplus.]

Very uncertain, but nearly all forecasts see continued surplus - albeit below last year's record level.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate

[Since last autumn sterling has remained broadly stable and is currently over 12 per cent below its effective rate peak early last year. Recent lows have been $1.77 on 14 September, DM4.07 on 20 October. Highs were $1.97 on 30 November, DM4.407 on 9 February. Rates at noon on 2 April were $1.7996; DM4.291 and an effective rate of 91.06. Reserves at end March stood at $19.0 billion, compared with $23.4 billion under the old valuation at end February.]

The Government has no target for the exchange rate. The rate is taken into account in interpreting domestic monetary conditions and taking decisions on policy.

2. Has the Bank intervened to support the rate?

The Bank intervene to smooth excessive fluctuations and preserve orderly markets. They do not seek to maintain any particular rate.

3. Concerted intervention to reduce the value of the dollar?

All the experience in recent years is that exchange rates for major currencies cannot be manipulated by intervention alone. Intervention can help to steady markets, but not counter major exchange rate trends. That takes changes in real policies, affecting interest rates, monetary conditions and fiscal policies. Lower US inflation is in everyone's interest: the matter for real concern is the US fiscal/interest rate mix, a problem all countries are familiar with.

4 Sterling should join the EMS?

[See N10-11]

5. Lower the exchange rate to help UK competitiveness?

Sterling's effective rate now over 13 per cent below its 1981 peak. But experience of successive devaluations in the UK has shown that attempts to manipulate the exchange rate are no solution to problems in the real economy. Only effective way to gain competitiveness is to control domestic costs-in particular wage costs. There are now signs of genuine progress: in 1981 wage costs per unit of output in manufacturing industry rose only 2½ per cent - less than in most of our competitors.

6. Why has revaluation of reserves led to such a large fall?

[Revaluation ~~of~~ reduced reserves from $23.2 billion to $19.0 billion, a reduction of $4.2 billion.]

Because of the rise in the dollar since March 1981 the value of our non-dollar convertible currency holdings as expressed in dollars is less. At the same time the value of each dollar's worth of reserves is more. Similarly the dollar price of gold has fallen considerably in value over the past year. (Gold held in the reserves (other than that swapped for ecus) has been revalued at 75 per cent of the final fixing price on 31 March, according to the usual formula used in the annual revaluation.)

7. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to $14 billion by end of 1981. This has been more than achieved - external debt is now around $13½ billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. 'Mandate negotiations'

At meeting of Foreign Ministers on 23 March, Presidents of the Commission and Council put forward (on a personal basis) a possible arrangement for future refunds to the UK. Foreign Ministers greeted the proposals with interest, and agreed to study them further at meeting to be arranged [3 April meeting postponed because Foreign Secretary could not attend].

2. Link with CAP prices?

All member states agreed that the three chapters of the mandate (development of Community policies, agriculture and the Budget) must be taken together. The agricultural chapter and the budget chapter will therefore be carried forward in parallel.

3. Net UK contribution to community too high?

A lot lower than it would have been without the refund agreement of 30 May 1980.

4. UK refunds in respect of 1981

Commission paid us before 31 March £813 million for supplementary measures as first instalment of our refunds in respect of 1981. This represents 81 per cent of our entitlement for that year. Our net contribution for 1981-82 is now put at some £200 million - very substantially less than it would have been without the 30 May 1980 budget agreement.

5. Lower Commission estimates of net contributions in respect of 1980 and 1981?

Most recent Commission estimates suggest that our net contributions in respect of 1980 and 1981 will be significantly lower than expected at time of 30 May Agreement. That is very satisfactory. For we remain one of the less prosperous Member States.

6. Budget refunds reduced if net contribution less than originally estimated?

The UK is clear that minimum net refunds payable under 30 May agreement are 1175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

7. Do supplementary measures grants lead to additionality?

There is additionality in that refunds enable public expenditure in the regions and elsewhere to be higher than would otherwise have been possible.

8. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

9. Costs of CAP to UK consumers

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

EUROPEAN MONETARY SYSTEM

10. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

11. Join the EMS for exchange rate stability?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

P INDUSTRY

1. Budget does not do enough for industry?

Budget measures directed at helping business and will cost £1 billion in 1982-83. On indexed basis over 2/3 of Budget's net revenue cost will go to help businesses. But main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates.

2. Industry's response to Budget?

[Sir Raymond Pennock, CBI President - 'welcome fillip' to business confidence. Sir Terence Beckett, Director General CBI - 'moves in the right direction'. ABCC - 'insufficient and misconceived'. Saturday 13 March Financial Times Marplan survey of industry's reaction reports 77 per cent thought it 'fairly good' for the economy and half those polled thought would reduce inflation.]

Have noted the Association of British Chambers of Commerce's adverse comments, but pleased with the generally favourable response from industry, including CBI.

3. Prospects for industry-recovery?

Fall in output has now come to an end. Industrial production in Q4 1981 ½ per cent up on Q3 and some 2 per cent up on H1. Budget forecast suggests there may be 3 per cent increase in manufacturing output in 1982 as a whole. March CBI enquiry and FT opinion survey encouraging (see B3).

4. Company sector finances improved?

[Gross Trading Profits of industrial and commercial companies (ICCs) net of stock appreciation rose strongly in H2 1981 (up 23 per cent between H1 and H2) and were 10 per cent higher in 1981 than in 1980. Borrowing requirement of ICCs has improved over year to Q3 1981, and financial deficit turned into surplus. DOI's latest survey of company liquidity (published 5 March) showed that at the end of Q4 1981 liquidity ratio was lower than at end of Q2, although still well above mid-1980 levels.

Figures encouraging. Company financial position is in any case confused by effect of civil service dispute. After adjustment for stock appreciation and excluding North Sea, ICC profits have stabilised since mid-1980. Improvement in financial position partly reflects destocking and action to reduce overmanning.

5. Rate of return still too low?

[Real pre-tax rate of return of non-North Sea ICCs rose marginally to 2½ per cent in 1981 Q3 compared to 2¼ per cent in Q2 (a record low).]

Yes, but Government can only help in limited ways such as reducing burden of NIS and creating the climate for lower interest rates. Further improvements in ICC's profits and real rates of return can be expected, provided recent productivity gains and trend towards moderate settlements continue.

6. High interest rates damaging for industry and investment?

[Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.]

Budget measures have eased pressure on interest rates, and the recent ½ per cent fall in the banks' base rates is encouraging. But Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Continuing relatively high level of interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFS. (See brief J).

7. Government help for small firms

Budget provided further help for small businesses in addition to 75 measures taken previously. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme this year (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

8. Response to Loan Guarantee Scheme?

Scheme operating successfully. We have already issued more than 2,700 guarantees - well over half to new businesses. Total lending under scheme is just under £100 million. Ten new banks were admitted to the Scheme in November 1981: a total of twenty-seven financial institutions are now participating. Budget provided for the lending ceiling - in year to May 1982 - to be raised from £100 million to £150 million. A further £150 million will be made available in following year.

9. Progress with setting up Enterprise Zones?

Excellent progress being made. Ten of the eleven zones are already in operation. We expect the final zone - Isle of Dogs - to come into operation in late April 1982.

10. Response from private sector?

Response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

R NATIONALISED INDUSTRIES

GOVERNMENT RELATIONS WITH NATIONALISED INDUSTRIES

[Industry Secretary announced 15 March that Government is to change its dealings with nationalised industries by agreeing objectives with each, putting more emphasis on efficiency by increasing Monopolies and Mergers Commission references and through board structures, and by strengthening business expertise in Whitehall.]

1. Whitehall making a take-over bid for the industries?

A distinction needs to be made between monitoring and interference in management. It is crucial for officials and Ministers to be informed about the industries' progress and about any problems that arise; but equally there is no intention to interfere with the proper role of management within the industries.

2. Industries hostile?

Government's proposals have been discussed with the Nationalised Industries Chairman's Group. They support the objectives underlying the proposals and have made a number of constructive comments. But the changes will affect Whitehall as well as the industries.

EXTERNAL FINANCING LIMITS

3. EFLs for 1982-83 and future years?

Nationalised industries' total external finance increased by £1.3 billion in 1982-83, £1.7 billion in 1983-84, £1.2 billion in 1984-85 - a total of over £4 billion over the three years of the Survey. Government has given full recognition to problems faced by the industries in a period of recession. Increase in 1982-83 was roughly half what the industries bid for.

4. Unreasonable to reduce EFLs following NIS cut?

Reduction in the National Insurance Surcharge was designed to benefit private sector; not the intention that public sector should gain from it. Reduction in EFLs will simply offset the addition to the industries' internal resources following the NIS cut. No industries will be worse off than previously, and their plans should be unchanged.

5. Pay assumptions?

Government has not set pay or any other assumptions for the industries. Moderate pay settlements - and restraint of current costs generally - essential if investment programmes to be maintained and prices to consumers kept down.

6. External financing outturn for 1981-82 way over original limits?

During 1981-82, five industries had their external financing limits increased by a total of £0.5 billion, met from the Contingency Reserve. In granting these increases, Government recognised problems faced by some industries in a period of recession, and that, in some circumstances, EFLs could not be immutable. Not yet possible to make full assessment of ASLEF strike, but three industries in particular - National Coal Board, British Steel Corporation and British Rail itself - have been adversely affected in short term.

INVESTMENT

7. Investment plans for future years?

Overall, industries' investment plans on a rising trend. [CAUTION: Not true for each individual industry.] Increase in total planned expenditure on fixed assets since last White Paper is £200 million in 1982-83, £600 million in 1983-84 and £700 million in 1984-85, ie an increase of £1.5 billion over the three years. This implies total investment of no less than £24 billion over the three years. 1982-83 plans allow for 26 per cent more investment than in 1981-82, and 40 per cent more than in 1980-81.

8. How robust are the forecasts of nationalised industry demand/contributions to public expenditure, given the recent track record?

Plans just published are considerably less optimistic than those published last year, when the industries' plans assumed a return to near-total self-financing by 1983-84. In particular, in increasing substantially the external finance available to the industries in each year of the Survey the Government has recognised the effect of lower demand on the industries' internal resources, which are now expected to be well below the levels in last year's White Paper - by about £2 billion in each of the years 1982-83 and 1983-84. The industries' external financing needs are still expected to decline over the Survey period, but from a higher base and at a more gradual rate than forecast last year.

9. Investment plans unlikely to be attained?

No Government can unconditionally guarantee a level of investment by the nationalised industries. Approved levels set out in White Paper are consistent with the industries' agreed external financing requirements, on the basis of the internal resource forecasts they have prepared. But perfectly possible that the plans might need to be revised, for example if the industries fail to restrain their current costs, including pay.

10. <u>But shortfall in capital spending 1981-82</u>?

[Figures in FSBR imply shortfall of £$\frac{3}{4}$ billion.]

Not easy to establish firm reasons after the event. Such evidence as we have suggests a mixture of reasons. Most important has been a cut in investment in response to changed circumstances such as lower market demand. These cuts have been extraneous and have not borne any direct relationship to EFL pressures. Other cuts have been for wholly beneficial reasons, such as lower than expected inflation and cost savings.

11. <u>Take nationalised industry investment out of PSBR</u>?

Real problem of pressure on resources cannot be solved by changing statisticval definitions. Since nationalised industries are part of public sector, their borrowing - for whatever purpose - must be definition form part of public sector borrowing requirement.

12. <u>Private finance for NI investment</u>?

[NEDC Working Party's study of nationalised industry investment was discussed at Council's 5 October meeting: agreed there should be review of progress to be completed by June 1982.]

We have indicated our willingness to consider new financing proposals. But direct market finance can only be justified if there is a genuine element of performance-related risk for the investor, in order to improve incentives to management efficiency, and if new forms of saving are tapped, so as to avoid adverse monetary consequences. Market financing does not of itself lessen burden on financial markets.

13. <u>Does the Government propose to sell shares in BT</u>?

[Front page <u>FT</u> Monday 15 March.]

Recent press reports are speculative. As the Chancellor announced in his Budget statement, detailed work is proceeding on the Buzby bond. The Government continues to examine ways in which market pressures could be brought to bear on nationalised industries, including BT.

14. <u>Finance more nationalised industry investment by cutting current spending</u>?

Yes. As in private sector moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries is bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

NATIONALISED INDUSTRY PAY AND PRICES

15. Nationalised industries' prices

Nationalised industries' price rises have been due in part to ending of previous Government's policy of artificial and distortionary price restraint between 1974 and 1980. But since middle of 1980-81, gap between NI price increases and RPI has narrowed. Artificial price restraint would result in unacceptable increased burden on taxpayer and distortion of market forces.

[CAUTION: gap between NI and 'all items' RPI could widen again in near future. Factors include LT fare increases in spring, winter electricity discount scheme ending, dropping out of RPI of last year's double revalorisation of excise duties.]

16. Action in Budget to help industrial energy users?

Total benefit to industry estimated at £150 million in 1982-83 from measures in Budget (combined effect this Budget and last is £250 million over two years 1981-83), namely freeze on industrial gas prices from 1 April to end-1982; new tariff arrangements for largest electricity users (and continuation of arrangements on electricity prices announced last year); standstill till next winter on list prices for foundry coke; extension of boiler conversion grants scheme.

PRIVATISATION

17. What further sales expected?

Special sales of assets in 1982-83 are forecast at around £700 million and around £600 million in each of the later years. These figures are well above those in last White Paper. This reflects primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - which are to be made possible by Oil and Gas (Enterprise) Bill currently before the House.

18. Net figure for special asset sales this year?

[Public Expenditure White Paper showed net sales of only £50 million in 1981-82; latest estimate published in FSBR is -£100 million - ie £100 net purchases.]

The low net figure is the result of decision not to proceed with a further programme of advance oil sales in a weak market. The gross figure expected to be in line with the £500 million target included in the last White Paper, and will include the proceeds from Cable & Wireless, the sale of Amersham International Limited and the National Freight Company Limited, the sale of the Government's shareholding in the British Sugar Corporation, and further sales of motorway service areas long leases.

19. Government simply selling valuable national assets to achieve PSBR target?

Of course the cash is welcome, but benefits run wider than that. Not only will any future borrowing by these undertakings be outside the PSBR, so reducing burden on taxpayers, but the organisations concerned will be made more responsive to market forces and thus have greater incentives to improve efficiency.

20. Government running into heavy weather over sale of Wytch Farm?

The British Gas Corporation is complying with the Government's direction to sell its interest in Wytch Farm. It is too early to say when the sales will take place.

21. Special disposals programme just a subsidy for speculators?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices where shares first traded.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially where company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares.

S NORTH SEA AND UK ECONOMY

1. In view of recent falls in price of oil, why did HMG not reduce tax burden on North Sea oil producers?

[Budget tax changes included abolition of Special Petroleum Duty, increase in Petroleum Revenue Tax rate from 70 per cent to 75 per cent, and new system for advance payments of PRT (all from 1 January 1983), plus smoothing of PRT payments from July 1983 (this improves HMG's cash flow at companies' expense). Changes reduce the marginal rate of tax (from 90.3 to 89.5 per cent); involve slight fall in Government 'take' (no change 1982-83, costs £70 million 1983-84).]

Recognise need for tax structure robust to both falling and rising prices. Detailed study showed us that under new structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that new tax structure will provide more secure and stable regime.

2. Government has missed opportunity to simplify North Sea fiscal regime?

The oil industry has made it clear that it would not welcome a structural upheaval. Would create serious uncertainty and major transitional problems.

3. Impact of falling oil prices on Government revenues and Government strategy?

[PM warned in 23 February speech that limited room for manoeuvre in Budget.]

Other things being equal, lower oil prices will reduce Government revenues from the North Sea. Treasury has estimated that each $1 off the price directly reduces revenue, other things being equal, by £250 million in first year and £350 million in full year. Chancellor warned in his Budget statement he could not rule out possibility of having to take action to correct the fiscal balance if there were to be a marked and prolonged fall in oil prices. But falling world oil prices are good for the world economy. We will benefit from that - not only from impact on activity, but also lower oil prices will help in reducing inflation.

4. Implications of OPEC production limitation agreement for North Sea oil prices?

Remains to be seen whether the agreement will hold, and whether world oil prices will harden as a result.

5. Benefits of North Sea should be used to strengthen the economy?

[FSBR projections (in money of the day) of Government revenues from North Sea: £6.4 billion in 1981-82, £6.2 billion in 1982-83, £6.1 billion in 1983-84, and £8.0 billion in 1984-85. Lower than last year's projections, principally because of downward revision to oil price expectations. Projections already incorporate fall to $31 a barrel for Forties oil. Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise before 1985.]

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

6. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

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

North Sea revenues are already committed. Setting up a special Fund would make no difference. More money would not magically become available. So the money for this Fund would have to come from somewhere else. This would mean higher taxes or lower public expenditure, if public sector borrowing is not to rise. If borrowing did rise, then so would interest rates. Not obvious that net effect would be good for investment.

8. Does HMG endorse conclusions of Bank of England article on North Sea?

[BEQB March issue. Also recent Treasury Working Paper No 22 'North Sea oil and Structural adjustment'.]

Broadly, yes. Useful contribution to debate. Agree that we are better off with oil at current oil prices - than we would have been without it. We have been spared the fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil is costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for the possession of oil to require a contraction in our industrial bade.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Government will have no choice but to reverse policies now unemployment has risen to post-war record levels in many Western countries?

Unadjusted unemployment exceeded 10 million in USA and 1 million in Canada in January. It exceeded 2 million in Italy in September, 2 million in France in October, and 1.9 million in Germany in February. Highest ever unemployment levels in Canada, France, Italy and UK and highest in USA and Germany since 1935.]

No indication of a widespread departure from consensus achieved last year (eg Ottawa Summit, IMF Interim Committee) about need for prudent fiscal and monetary policies to bring down inflation.

2. Anti-inflation policies not working?

[Year on year consumer price inflation in major countries fell to 8.5 per cent in February. Underlying rates falling in US. OECD and IMF expect some decline in 1982.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980: some decline expected 1982.

3. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

4. Other countries giving priority to reducing unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

5. Other governments not following such stern policies as UK?

[Most major countries (US, Japan, Germany, Italy, Netherlands, Belgium, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Belgium government has used its special powers to freeze prices temporarily and severely curtail wage increases for rest of 1982.]

an/

Most governments presevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

6. UK is alone in Europe. Even Germany announced investment/employment scheme?

UK far from alone. Almost all European governments working to curb public spending, budget deficits and monetary growth. French government has set limit on its budget deficit for 1983 of 3 per cent of GDP. German government plans to reduce its borrowing in 1982 Budget even in nominal terms by almost 30 per cent. Unlikely investment/employment scheme will entail any significant increase in borrowing - increase in VAT (by 1 per cent to 14 per cent) part of the package from 1 July next year. Impact on employment remains to be seen.

7. Prospects for UK economy worse than for other countries?

No. Treasury and most independent forecasters expect UK growth this year of about 1½ per cent rising to an annual rate of 2 per cent by early next year. This is very closely in line with the OECD's forecast for OECD Europe. Unemployment is expected to rise in all major countries except Japan. UK inflation (GNP deflators) likely to be around the OECD average and below that in France, Italy and Canada.

8. Prospects for US economy?

[Industrial production rose 1.7 per cent in February after falling 2.5 per cent in January. Inflation in January was 8.4 per cent compared with a year earlier. Three-month interest rates slower than in February.]

Things are looking a little brighter in the US both on output score and, with lower interest rates, an improving outlook for inflation. And on the industrial relations front, there have been some encouraging settlements in which unions have clearly accepted lower wage increases in exchange for improved job security. [CAUTION: Not too much should be made of this: some upturn in US economy in the spring was expected.]

9. Even US using fiscal deficit to stimulate economy?

True US deficit is larger than anticipated. It is planned to fall but present level carries risk of prolonged period of high interest rates which could delay a European recovery. We strongly support the determination of the US authorities to combat inflation. But we believe fiscal and monetary policies must work together to that goal.

10. Recent international interest rate developments?

True that US interest rates rose earlier this year. But prime rates are well below their peak of 21½ per cent last summer (currently 16½ per cent)

11. Prospects for international interest rates?

Always difficult to force interest rates with certainty, but firm and balanced policies should over a period bring lasting reduction in both inflation and interest rates.

AIDE MEMOIRE ON THE UK ECONOMY 5 April 1982

PRESENT SITUATION

Clearly a range of outside forecasts; from ITEM and CEPG the more pessimistic to Liverpool more optimistic. Most major post-Budget assessments (LBS, NIESR, St James, P&D, St J) judge impact of Budget and falling oil prices favourable. Output by those groups forecast to grow about 1½ per cent in 1982 (cf FSBR's 1½ per cent), inflation to fall to single figures by end 1982 (cf FSBR's 9 per cent in 4Q 1982); therefore very much in line with FSBR. All groups expect continued rise in unemployment (UK adult sa) during 1982 to around 3 million. Forecasts for 1983 vary, from some groups expecting further rise, to others (P&D, Simon and Coates) expecting some slight decline (roughly 50,000-100,000) and Liverpool expecting fall of 400,000.

GDP output estimate rose in both Q3 and Q4 1981. Level in Q4 some 1 per cent above Q2. Recent months' industrial output figures affected by bad weather, car and rail strikes. Nevertheless, Q4 1981 manufacturing output some 2-3 per cent above low point in Q1 1981.

Consumers' expenditure rose about 1 per cent in Q4 1981: the overall level in 1981 was the same as in both 1980 and 1979. Retail sales were virtually unchanged in the 3 months to February 1982. The volume of visible exports in the last few months of 1981 were high compared with the level earlier in that year but there was a sharp drop in this volatile series in January 1982. Latest evidence indicate that there has been a significant rise in the volume of visible imports since the middle of 1981. DI investment intentions survey conducted in October/November suggests volume of investment, by manufacturing, distributive and service industries (excluding shipping) will rise by about 2 per cent in 1982 following a fall of about 5 per cent in 1981. A large rise is tentatively expected in 1983. Investment by manufacturing (including leasing) is expected to rise during 1982, but for the year as a whole it is likely to be 1 per cent lower than 1981. An appreciable rise is expected in 1983. Manufacturers', wholesalers' and retail stocks dropped by £25 million (at 1975 prices) in Q4 1981 the smallest quarterly fall in the last two years of continuous destocking.

Unemployment (UK, seasonally adjusted excl, school-leavers) was 2,822,500 (11.8 per cent) at March count, up 5,000 on February. Vacancies were 110,600 in March.

Wholesale input prices (fuel and materials) fell 2 per cent in March causing the year-on-year increase to dip to 8 per cent. Wholesale output prices rose ½ per cent in March but fell to 9½ per cent above a year ago. Year on year RPI increase fell to 11.0 per cent in February. Year-on-year increase in average earnings was 10.8 per cent in January. RPDI was flat in

the last three quarters of 1981; it fell 2 per cent between 1980 and 1981 after rising 17 per cent between 1977 and 1980. The savings ratio fell 0.7 points to 13.1 per cent in Q4 1981.

PSBR £9.7 billion in the first three quarters of 1981-82 and CGBR (unadjusted) £8.1 billion in eleven months to February 1982; but both distorted upwards by the civil service dispute. Underlying PSBR for '81-82 believed in line with 1981 Budget forecast (£10½ billion).

Sterling M3 was little changed in banking February.

Visible trade has showed a surplus of £0.5 billion in the 5 months from September 1981. Current account surplus over same period of £2 billion and likely surplus in 1981 as a whole £8 billion . UK official reserves following revaluation were $19.0 billion at end-March. At the close on 2 April the sterling exchange rate was $1.786: the effective rate 91.0.

SECRET

cc Mr. Hoskyns
Mr. Vereker

PA Econ Pol

Prime Minister ①

Yes – Content for Alan to pursue these discussions? Or would you like the Chancellor to present the options at X to you?

MLS 2/4

PRIME MINISTER

CONVERSION 1982

1. Just 50 years ago, Neville Chamberlain carried out the largest and most successful conversion operation in financial history. It was also, incidentally, a great political coup. The circumstances were not too dissimilar from those of 1982. Britain was emerging from a deep recession. Then, however, there had been a substantial deflation and the price level was still falling. The real interest rates on debt with a 5% coupon were very high - probably 9%. Chamberlain's coup was to convert to irredeemable low coupon stock and "relieve the Exchequer of a great burden".

2. Of course, 1982 is very different in one respect. We have a continuing but rapidly falling inflation. However we do have a large quantity of longish gilts with yields around 14%. Our basic funding instrument is still the long-dated conventional gilt.

3. The real interest rate on these conventional gilts depends on the rate of inflation, say over the next five years. But the expected rate of inflation depends critically on whether or not we are returned to power at the next general election. If we do come back, then I would conjecture that the average inflation rate is likely to be in the region of 5 or 6% over that period. I suspect that that prognosis is probably lower than the views of most people. But perceptions are changing quite rapidly in a downward direction. Alternatively, if we lose the election, then there is a chance of either an SDP or Labour Government or some coalition. Then I suspect the inflation rate would jump markedly and perhaps be of the order of 10 or 12% (or even more with a left wing Labour Party in power).

4. The important point, however, is that, if we win, the real rate of return on financial assets like gilt edged securities purchased today, will be over the next five years round about 8 or 9%. This compares with a yield of 2½-3% on indexed gilts. (On the other hand, if there is an inflation rate of 12% then of course the holder of conventional gilts will suffer compared with the man who holds indexed gilts.)

/5. For obvious

SECRET

5. For obvious reasons I believe it is important that our present policies be framed on the assumption that we win the general election. Then there is a prima facie case for a substantial conversion operation. If we do not convert to reduce these real yields, then there will be a considerable diversion of resources into the coffers of the gross funds which are predominant in holding long-dated conventional gilts. I do not think this is desirable in terms of the distribution of resources, and it is, of course, financially embarrassing.

6. Granted that we should consider conversion, there is a large number of options and programmes which are open to us. Although I have spoken so far only about indexed gilts as an alternative to conventionals, ~~there are many~~ other instruments such as the variable rate bond, the call option, drop-locks and no doubt many others yet to be devised. Similarly, there is a large number of ways of implementing this programme. One might simply stop issuing conventional stock and push indexed gilts or variable rates. Alternatively, one might offer optional redemption arrangements on existing stock. Similarly, the appropriate timing and sequencing has to be chosen with care. But all these are details which can be debated and thrashed out at a later stage.

X

7. However, I am quite convinced that we should not ignore the possibilities of reducing real interest rates over the next Parliament from around 8% to around (say) 3.5-4% on a substantial fraction of government debt. Consequently I have already alerted Peter Middleton, Eddie George and John Fforde to my thoughts on conversion operations. They see the strength of the case. The Bank, however, are ~~understand-~~ ~~abl~~y reluctant to take steps which they would regard as dramatic.

predictably

8. As you will readily surmise, the gains from a conversion operation would come from a situation where the price of conventional stocks is low and the yields are high. In view of the likelihood of a fall in American interest rates during this year, it may well be that the opportunity will be lost if we delay too long. In markets the fleeting moment must be grasped lest it be for ever lost.

9. I will keep you informed of the progress of these discussions.

AW

2 April 1982

ALAN WALTERS

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Econ Pol

PPS/CHANCELLOR

file no TEB/CA/01

copied to:

Mr Salveson (for transmission to No.10)
PS/CST
PS/FST
PS/MST(C)
PS/MST(L)
PS/Home Secretary
PS/Lord Chancellor
PS/Foreign Secretary
PS/Secretary of State for Education and Science
PS/Lord President of the Council
PS/Secretary of State for Northern Ireland
PS/Secretary of State for Defence
PS/Minister of Agriculture, Fisheries and Food
PS/Secretary of State for Environment
PS/Secretary of State for Scotland
PS/Secretary of State for Wales
PS/Lord Privy Seal
PS/Secretary of State for Industry
PS/Secretary of State for Social Services
PS/Secretary of State for Trade
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 22 March, are sidelined. In particular, we are now providing some material on the responsibilities transferred back to Treasury from the former CSD. This will be found in our (new) Section F.

M M Deyes

M M DEYES

RA

R I G ALLEN

29 March 1982

EB Division
H M Treasury
01-233-3364

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation and promotion of enterprise and initiative. Reduction of inflation requires maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Relative importance given to inflation and unemployment?

Government is concerned about both. These are complementary not competing objectives; unemployment important economic and social problem. But will not be reduced by relaxing struggle against inflation.

3. Effect of falling oil prices?

Very welcome: in some ways like a cut in indirect taxes or NIS supporting recovery and lower inflation. Does reduce room for manoeuvre through fall in Government revenues, but also need for tax reductions. [IF PRESSED on fiscal implications of continued oil price falls: would be of substantial future benefit to inflation and output. As Chancellor said in Budget Speech, wholly irresponsible to rule out possibility of action to adjust fiscal balance.] (See also Section S).

4. Contribution made by 9 March Budget?

Budget continues Government's medium-term strategy for economy. Designed to make further progress on inflation and restore base for economic growth, improved output and increased employment. Tax cuts and other measures designed to help both business and individuals, within responsible fiscal framework.

5. Reflationary/deflationary/effect on demand?

Oversimple questions. Wrong to talk about what government is 'putting into' or 'taking out' of economy. Ignores links between fiscal and monetary policy and their effects through financial behaviour (interest rates and exchange rate), on economy. Budget's overall effect is to support sustainable recovery.

6. Effects of Budget and December announcements together?

[December announcement provided for £5 billion increase in public expenditure plans for 1982-83 and increased NIC rates yielding £1 billion extra revenue. But total Government revenue in 1982-83 now expected to be some £3½ billion higher than at time of 1981 Budget.

Taking account of all these changes, pre-Budget PSBR for 1982-83 about £8¼ billion; post-Budget forecast about £9½ billion.]

No simple answer to this question. So much depends on base one starts from, and what counts as a policy change. Overall effect is reflected in PSBR for 1982-83 a little higher than planned in March 1981. But important thing is continuing decline in PSBR, with benefits for interest rates already apparent, plus substantial cuts in taxation.

7. <u>Bank of England forecast for economic recovery much more gloomy than PSBR outlook</u>?

[Press coverage of Bank of England Quarterly Bullentin published 25 March]

Not a fair reading of the Bulletin. True that Bank stresses uncertainties stemming from high world interest rates etc. But so too does FSBR. Bulletin notes that FSBR forecast is broadly in line with independent forecasts after making allowance for Budget - which Bank argues will improve prospects for growth and inflation - and recent falls in oil prices. And Bank stresses that favourable developments in productivity, pay and inflation 'in general place the economy in a better position to respond favourably to a revival of demand.

8. <u>Not enough help for industry</u>?

Main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates. In addition, specific Budget measures aimed at industry and business will cost about £1 billion in 1982-83. Signs of recovery in profits and financial position of industrial and commercial companies. (See also Section P).

9. <u>Does more for industry than for people</u>?

Help to industry <u>is</u> help to people. Higher allowances and thresholds more than compensate for inflation in last year and make up some of ground lost last year. Many other smaller changes (eg on charities) will help particular groups of people.

10. <u>Another Budget pushing up prices</u>?

No. Changes in excise duties slightly less than required for full revalorisation. 12-monthly inflation rate now 11 per cent (February figure published 19 March) - down from 12 per cent in January. Further fall forecast to 9 per cent by November 1982.

11. <u>Effect of Budget on personal incomes, incentives etc</u>?

See Section D.

12. Fiscal policy should be based on cyclically adjusted/real PSBR?

See Section H.

13. Monetarism dead?

'Monetarism' a much over-used, misused and misunderstood word. Medium-term framework provides essential reference point for policy. Nonsense to suggest MTFS is being slavishly and dogmatically adhered to. Only right to take account of changing circumstances: that is what we have done. But such adjustments do not reflect any weakening in resolve to tackle inflation. Judged by results, policy is succeeding. Inflation has been reduced and is now coming down again.

14. If this is as claimed, a Budget for output, and employment , how many jobs will it create?

Budget forecast shows continuation of recovery; but it is not the practice to publish estimates of the overall effects of the Budget, or its individual measures, on employment or output.

15. Not keeping to commitments to reduce expenditure?

Increases announced in Budget offset by reductions leaving totals still around £115 billion. FSBR shows declining ratio to GDP in future years. (See also Section E).

16. Armstrong/unified Budget?

[TSCS will be questioning Chancellor on this 5 April].

Proposals have wide implications. Need careful consideration. Government does take account of tax and expenditure when taking decisions on each. Await TCSC report with interest.

17. Labour Party's 'Plan for Jobs'

Previous Government's policies did not prevent unemployment from rising to levels exceeding 1 million for three quarters of their term of office. Under social contract with last Labour Government RPI-measured inflation reached nearly 27 per cent and wage inflation over 30 per cent. Subsequent reduction followed by 'winter of discontent'. Withdrawal from EEC and control of imports would cause severe dislocation and inefficiencies.

18. Programmes 'run through Treasury model'

Use of Treasury model to try to quantify effects of 'Plan for Jobs' (or any other suggested measures) does not of itself guarantee accuracy or confer credibility. Results depend on judgments and assumptions fed in more than 'pressing buttons'.

BULL POINTS

As at 29.3.82 (Tape 455)

(i) Signs of recovery

- Total output (GDP) rose in both 3Q and 4Q 1981. Level in 4Q about 1 per cent above 2Q.
- Short time working in manufacturing fell in 1981 to below ¼ its January peak;
- 1981 figures show volume of engineering and construction orders up about 14 and 10 per cent respectively on 2H 1980.
- Private sector housing starts in 1981 up by 37 per cent on 2H 1980.
- Most recent major independent forecasts assess low point in activity reached in 1H 1981; prospect of some recovery in 1982.

(ii) Earnings and settlements. Increases halved in 1980-81 pay round. Public sector in line. There is a good deal of evidence that average settlements in private sector are running lower than in the 1980-81 round. [CBI pay data bank for manufacturing settlements suggests average is now around 7 per cent compared with 9 per cent in previous round.]

(iii) Productivity. Output per head in manufacturing rose 10 per cent during 1981. Investment in plant and machinery holding up well.

(iv) Unit labour costs: Pay moderation and higher productivity has meant dramatically low increase in manufacturers unit wage costs over last year - just 2½ per cent in year to 4Q 1981. Recent rate of increase below the average of our major competitors and comparable to that of Germany and Japan.

(v) Competitiveness. Improved by over 10 per cent during 1981, reflecting pay moderation combined with exchange rate fall.

(vi) Profits: Industrial and commercial companies gross trading profits (net of stock appreciation) rose strongly during 1981, up 28 per cent between 1Q and 4Q 1981.

(vii) Exports holding up well; non-oil export volumes in 4 months to December up 3½ per cent on 1980. 1981 figures show engineering export orders up 17 per cent on 2H 1980.

(vii) Unemployment. Rate of increase in unemployment slowed further in 1Q 1982 to just 1/5 that in 4Q 1980. Vacancies improving since mid 1981. Short-time working in manufacturing reduced by over ¾ during 1981 and overtime working has increased.

(ix) Special employment measures. Total provision on Job Release Scheme, Temporary Short-Time Working Compensation and Community Enterprise Programme in 1982-83 now planned to reach over £520 million, with additional £61 million for young worker scheme (starting January 1982). Spending on Youth Opportunities Programme to rise to £700 million

1/3

in 1982-83. 280,000 unemployed school-leavers last year found places on YOP by Christmas.

(x) Training. Over next 3 years £4 million to be provided to bring training schemes up to date. New Youth Training Scheme for school leavers to be introduced September 183 represents major step towards comprehensive provision for young people.

(xi) Industrial relations. Number of strikes in 1980 and 1981 less than in any year since 1941 and number of working days lost only a third of average of last ten years.

(xii) Retail prices. Inflation halved since peak in spring 1980 (21.9 per cent). 12 monthly increase in February of 11.0 per cent.

(xiii) Share Ownership Schemes: Number of schemes has increased from 30 in May 1979 to over 400. Number of employees covered roughly doubled between first and second years in office. Profit sharing schemes alone now cover some 270 thousand employees.

(xiv) Examples of export successes reported in the Press include: £160 million contract for construction of two new colleges in the largest ever such contract between Britain and Nigeria (Mitchell Cotts Group); over £50 million contract for the installation of a gas turbine power station in Oman (John Brown Engineering with other UK firms); travelling hoists with exceptionally low headroom (550mm) for use in Danish oil and gas exploration platform in North Sea (Tonnes Force); and glazing for the new Financial Complex in Port of Spain - the biggest ever such gained by a UK glass processor (Clark and Eaton with Pilkingtons). New British-designed, managed and partly funded, domestic water supply project in Jordan was opened by King Hussein on 18 February.

(xvii) UK preferred location: US electronics industry survey reports UK most preferred location for establishing new plants.

(xviii) Overseas debt repayments. Official external debt reduced from over $13.3 billion at end-1981.

Economic Briefing Division, HM Treasury, 01-233 3819/5809

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent position?

All three GDP measures were higher in real terms in Q4 1981 then had been earlier in year. GDP (output) in Q4 was nearly 1 per cent up on Q2 - the earlier low point.
[IF PRESSED on apparent weakening of recovery (based on November/December/January industrial production) - see 2 below.

2. Recent manufacturing production figures show resumed decline?

[January figures show further fall in industrial and manufacturing production, now 3 and 4 per cent respectively below October levels, with manufacturing production at lowest point since 1967].

Only to be expected that January's index would show some further weakening. Series of factors (car and rail strikes, bad weather, holidays) have distorted the last three months. Despite this, manufacturing output in Q4 1981 some 2-3 per cent higher than its low point earlier in the year (Q1 1981). Preliminary indications for February suggest a pick up, with steel and car output up 16 and 12 per cent respectively, compared with January.

3. March CBI monthly enquiry

March saw further improvement in order books, and rise (to 4 per cent) in net balance of firms expecting to increase output in next few months.

4. Other evidence of improvement in economy?

See Bull Points (following Section A).

5. Government assessment of prospects

[FSBR forecast (9 March) assesses recovery to have begun. Main points are:

	per cent increase on year earlier	
	1982	1983 H1
GDP	1½	2
Manufacturing output	3	2
Consumers expenditure	½	½
Investment (private sector and public corporation)	4½	5
Exports	3½	3

Forecast expects some stockbuilding in 1982, Government expenditure flat.]

FSBR forecast sees prospect of some recovery continuing into 1983. (Last two Government assessments of economy were broadly correct). Healthy rise in private sector investment and exports. Inflation well into single figures (7½ per cent) by mid 1983. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

6. Outside forecasts

[GDP profile in recently released major forecasts:

	NIESR (Feb)	LBS (Feb)	CBI (Nov)	Phillips &Drew (Mar)	OECD (Dec)	FSBR (Mar)
Per cent change 1982 on 1981	+1½	+1½	+1	+1¾	+¼	+1½]

Most recent major independent forecasts assess that low point in activity was reached in first half of 1981, with prospect of continued recovery in 1982. As always, a range, with Cambridge forecasts being the more pessimistic. Many outside forecasters have not yet published their post-Budget assessments. Those groups that have assessed Budget measures and lower oil prices now expect higher output and lower inflation in 1982 - much the same as FSBR.

7. Gloomy forecast from Bank of ~~Elgnad~~ England?

[BEBQ March issue].

See A7.

C LABOUR MARKET

1. Recent unemployment figures?

[Unemployment (UK adult s.a) rose by just 5,000 to 2,823,000 (11.8 per cent) in March. Total unemployment fell by 53,000 to 2,992,000 (12.5 per cent). Average monthly underlying increases in adult unemployment (after allowing for men over 60 transferring to long term Supplementary Benefit) are:

Thousands

1980	1981				1982
Q4	Q1	Q2	Q3	Q4	Q1
105	77	62	51	33	21]

Repetition of February's small increase in adult unemployment seasonally adjusted, encouraging sign that rate of increase slowed markedly further this year.

2. Vacancy figures disappointing?

[Vacancies (UK seasonally adjusted) fell 2,400 in March to 111,000. Vacancy flow data for February (latest month available) show sharp rise in both inflow and outflow.]

Not too much should be made of one month's figures. Vacancies have been rising since middle of last year, and flow (ie vacancy turnover) has improved steadily.

3. Effect of Budget on unemployment?

Budget contributes to Government strategy of fostering conditions for sustainable growth. Help to business will lay foundation for more real jobs. Employment will benefit from some further improvement in activity. Proposed new non-profit-making scheme will enable local authorities and voluntary sponsors to provide many new jobs. (MSC to advise what possible: for illustration, Government prepared finance 100,000 at net additional Exchequer cost of £150 million).

4. Unemployment expected to continue rising rapidly?

[Outside forecasters see continued rise in registered unemployment during 1982 reaching about 3 million (UK adults) in Q4. Opinion divided for 1983, some (CEPG, Cambridge Econometrics, ITEM, NIESR) see rise continuing but at a slower rate others are broadly flat (LBS, St James, P+D); only Liverpool foresee a fall (400,000)].

Unemployment forecasts uncertain; independent forecasters encompass differing views for 1983 - several projecting stabilisation, Liverpool some decline. Rise in unemployment drastically reduced since end 1980. Clear evidence of further slowing down this year - Q1 1982 rise just 1/5 that in Q4 1980. Vacancies, short time and overtime all improved last year. Employment situation will benefit from some further recovery in activity this year.

5. Government forecasts for unemployment

[1982 PEWP uses working assumption of an average level of 2.9 million unemployed in Great Britain (excluding school leavers) in 1982-83 and rest of survey period. School leavers, adult students, temporarily stopped and Northern Ireland imply UK total unemployed of 3.2 million in 1982-83.]

Very difficult to forecast. Following well-established precedent of previous administrations is not publishing. Public Expenditure White Paper figures are planning assumptions not forecasts.

IF PRESSED that PEWP figures show Government planning sustained higher level of unemployment: No. Maintaining constant figure for the Survey period is conventional assumption adopted by previous Administration. PEWP figures consistent with the prospect of some fall in total unemployment before the end of 1982-83. They do not however necessarily imply this. If things go well - eg lower pay settlements, recovery in world trade - then reasonable to hope for fall in unemployment before end 1982-83.

6. Employment continuing to fall?

[Total employment declined 1.9 million or 8 per cent in 2 years to Sept 1981. Q3 figures indicate decline of 150,000 compared with 300,000 per quarter in H1 1981. Manufacturing employment declined by 34,000 a month in Q4, a little more than Q3.]

Third quarter decline in total employment half that in H1 1981. Manufacturing employment statistics show lower rate of decrease was maintained in fourth quarter.

7. Unemployment higher than in other countries?

[On standardised definitions in 3Q 1981 UK employment was 11½ per cent compared with 6¾ per cent OECD rate; a UK doubling compared with an OECD rise of a third since 1979.]

Whole world affected by rising unemployment. In our case we have additional self inflicted wounds of high pay awards and low productivity. Unemployment now rising very fast in some countries eg Germany.

8. Higher Exchequer costs of unemployment.? Recent Treasury estimates suppressed?

No 'right' figure. Estimates depend critically on assumptions used, the causes of unemployment and items of 'cost' covered. [IF PRESSED: Estimates have been made of cost of additional registered unemployment (eg for 1980-81 in February 1981 EPR). Attempt made to update to 1981-82 - range of figures has been calculated. But doubts expressed about assumptions used. Work, therefore, continues. No decision whether to publish.] Cannot gross up such figures to produce total cost (in terms of lost taxes and extra benefits) of all the unemployed. Meaningless concept. Implies comparison with an economy

with zero unemployment. Can say total expenditure on unemployment and supplementary benefits paid to the unemployed estimated at £4.3 billion in 1981-82 and £5 billion in 1982-83.

9. <u>What is Government doing to provide more jobs?</u>

Illusion to think Government can switch employment off and on like a tap. Government pursuing sensible fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless Government expanding schemes to meet special difficulties and improve training - eg plan to spend £1½ billion in cash on 1982-83 (40 per cent more than in 1981-82) on special employment and training measures; new Youth Training Scheme costing £1 billion a year from 1983-84; and new measure announced in Budget. (See C3).

D TAXATION

1. Burden of taxation

[Total taxation (i.e including for example income tax, indirect taxes, corporation tax,rates and NIC) in 1978-79 was 34½ per cent of GDP (at market prices), 36 per cent in 1979-80, 37½ per cent 1980-81. It is forecast to be 40 per cent in 1981-82 and 39½ per cent in 1982-83.]

This has inevitably increased during a time when the recession has been adding to public spending. Changes proposed in Budget will reduce total burden next year compared with 1981-82. [NOT FOR USE: not necessarily true of burden on persons.]

2. Burden of tax has risen since 1978-9 for most households has risen since 1978-79?

[Comparisons given in Parliamentary Answers to Mr Straw 3 December, 17 February and 18 March col W199.]

Slow growth of output and difficulty of restraining public expenditure have inevitably meant higher tax burden. But real personal income after direct taxes still higher than under last Government.

3. Burden has fallen for the rich?

Only because of abolition of absurdly high marginal rates and raising of thresholds in 1979 Budget.

4. Burden has risen most for the poor?

Proportion of income paid in income tax and NICs will fall next year (82-3) for lowest paid taxpayers.

5. Personal tax burden increased by the recent Budget - when NICs taken into account?

[Full explanation given in Parliamentary Answer 11 March OA col 955].

The real increase in personal allowances and tax thresholds will reduce income tax as a percentage of income at all levels of incomes. [IF PRESSED: In immediate cash terms, increases in personal allowances etc will compensate for NIC increase for majority of taxpayers. Taking into account increased earnings in 1982-83 (for example using the Government Actuary's 7½ per cent assumption) percentage of income paid in income tax plus NIC will rise for most people, but will fall for the lowest paid (below about ½ average earnings (married) and below about 1/3 average earnings (single)). Those over pension age who are taxpayers will benefit from income tax changes and will be unaffected by NIC rise, and, of course, State pensions are being uprated from November (see G1).]

6. Budget failed to compensate for last year's non-indexation?

Impossible to finance - without grave risks to interest rates and present recovery - the additional £3 billion cost.

7. No improvement in incentives?

There will be 1.2 million fewer taxpayers than if allowances had remained at 1981-82 levels, and ½ million fewer higher rate taxpayers. For the substantial number taken out of tax or with reduced marginal rates, incentives will improve.

8. Income tax cuts only help highest paid?

Not true: those who will gain most are lowest as well as highest paid i.e. gives greatest proportionate benefit to highest and lowest paid taxpayers, who did worst in last year's Budget.

9. No help on poverty trap?

Numbers in Poverty Trap should not be exaggerated. Increases in income tax allowances have a beneficial impact. [IF PRESSED: overall, small increase in numbers in poverty trap (10,000) as result of FIS uprating. But this helps low paid and generally makes employment more attractive than unemployment.]

10. Reduction in NIS not enough?

Cut welcomed by CBI and industry generally. Provides substantial help on business costs. 1 per cent reduction maximum possible without risks for PSBR: outright abolition too costly. And other measures to help business directly - energy, construction, innnovation and enterprise packages plus helpful - and welcomed - improvements in capital tax regime (see also Section P).

11. does Government intend to impose any further special tax on banks?

[Speculation in The Times 27 March]

We shall have to give much further thought in the coming year to the problem of how best to ensure a sufficient contribution to tax revenues from the banking sector.

12. Excise duties increases inflationary/harmful to industries

Increases in excise duties as a whole slightly less than broadly compensate for past year's inflation. Variations between duties take account of industrial considerations e.g supplementary increase last July on tobacco/Scotch whisky industry/help for industry by smaller increases on e.g derv - mainly used by industry.

13. Petrol/derv/VED increases anti-motorist/industry?

These three duties not singled out; increases as a whole no more than broadly compensate for past year's inflation. 2p smaller increase on derv further shields industry and distribution costs by increasing differential with petrol (10p a gallon) introduced last July.

14. Reduce VAT?

Reduction in standard rate not appropriate. Nearly half consumer expenditure zero-rated or exempt (including necessities like most food, housing, domestic heating). Applies equally to home production and imports. Assistance provided for whole of UK private sector through reduction in NIS.

15. Why no VAT relief for charities?

Not possible: high revenue cost; serious definitional and administrative difficulties; would have repercussions in other areas, which could seriously erode VAT revenue base.

16. Not enough to encourage (existing) small firms?

Substantial measures in enterprise package - full year cost about £80 million. (see also N7-8). Many of latest measures (e.g increase in 'small companies' Corporation Tax profits limits, VAT registration thresholds, purchase of own shares) benefit existing small businesses.

17. Government take from North Sea oil too high?

See S1.

E PUBLIC EXPENDITURE AND FINANCE

[Public Expenditure White Paper (Cmnd 8494) published 9 March. Gives planning totals of £115.2 billion in 1982-83, £121.1 in 1983-84 and £128.4 in 1984-85. About £5 billion higher than last White Paper in 1982-83 and £7 billion in 1983-84. Net effect of changes announced in Budget is to reduce totals to £114.9 billion, £120.4 billion and £127.6 billion].

1. Public expenditure too high?

Spending in 1982-83 planned to be about £5 billion (4½ per cent) lower than intended by last Government even if higher than planned when this Government first took office. Decisions to increase spending represent flexible but prudent response to changed circumstances e.g additional spending to help young unemployed. Drive for to improve management in public sector and reduce administration expenses continues.

2. Ratio of public spending to GDP is getting back to the peak levels of the mid 1970's?

Ratios in 1980-81 (43½ per cent) and 1981-82 (45 per cent forecast) remain below the level of 1974-75 and 1975-76 (46 per cent n both years). Rise in ratio in 1981-82 mainly reflects higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years: assumptions in MTFS would mean figures of 44½ per cent in 1982-83, 42½ per cent in 1983-84 and 41 per cent in 1984-85. Reflects assumed GDP growth and curbing of public expenditure.

3. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term, and would soon lead to more inflation and higher interest rates and inflation. We are responding, within limits of prudence, to needs of current circumstances.

4. Real terms comparisons

No volume equivalents of cash plans. But cash increase in plans between years is 9 per cent in 1982-83, 5 per cent in 1983-84 and 6 per cent in 1984-85 (and projection of GDP deflator in MTFS is rather lower than this in 1982-83, rather higher in 1983-84 and about the same in 1984-85). So in cost terms [i.e cash inflated/deflated by the general movement in prices] there is an increase in 1982-83, a decrease in 1983-84 and a small decrease in 1984-85.

5. Plans unrealistic, given e.g overspending in 1981-82/future rates of inflation?

Total spending in 1981-82 was expected to be only a little [NOT FOR USE: 0.4 per cent] higher than planned a year ago. Major reason for overspending is present level of spending by local authorities; this has been taken into account in plans. Realism, particularly in respect of local authorities and nationalised industries, is one reason why plans for future years are higher than in previous White Paper. Large Contingency Reserves due to greater uncertainty in later years and designed to give realistic planning totals.

6. Higher inflation than allowed for in PEWP may raise public spending?

True that inflation assumption in FSBR slightly higher than in PEWP, but:

- for 1982-83 confident that planning total including Contingency Reserve will hold;
- for later years inflation assumption in FSBR a little higher than cost factors used in building up cash programmes;
- in due course, will consider adequacy of cash provision on programmes.

Meantime, uncertainties due to, for example, inflation, are one reason for large Contingency Reserves in later years; makes for realistic planning totals.

7. NIS reduction: effect on public expenditure?

[Programmes will be reduced to reflect reduction in NIS paid by public sector. First estimates of effect (included in post-Budget revised planning totals) is some £360 million in 1982-83 and £450-500 million in later years.]

Government's intention in reducing the NIS is to help private industry, not public sector. Effect of clawback on public sector wil leave its position broadly unchanged. (See also P2).

8. Not enough capital expenditure?

Government prepared to give priority to worthwhile capital projects wherever this can be done within overall spending totals. Plans do allow for changes between 1981-82 and 1982-83 as follows:

- public sector spending on new construction increased by 14 per cent;
- nationalised industries investment to rise by 26 per cent;
- increase in housing investment output [NOTE: if LAs take full advantage of receipts from sales, gross new investment can be as high as £3 billion next year];
- slight increase in work done on water and sewerage projects even though provision reduced).

9. Cuts in capital

Some reductions in cash provision necessary, but recent falls in tender prices (following sharp increases between 1978 and 1980) will mean that programmes mainly affected (roads, water, local environmental services) should be carried out as planned. Planned capital expenditure also reflects decline in needs since early mid-1970s (e.g roads, schools).

Planned spending should not jeopardise future standards and availability of public amenities and services.

10. Cash planning means concentration on first year, not enough on services in later years?

Government recognise case for medium-term planning. But planning must be related to availability of finance as well as prospective real resources. Cannot accept unconditional commitment to forward plans for services. Volume plans formerly had to be cut when conflicted with financial constraints - e.g after IMF intervention in 1976.

11. End-year flexibility?

Possibility of end year flexibility is being looked at again. There could be some managerial advantages in such a scheme. But we also have to consider the question of cost.

12. Cash limits 1982-83 and public sector pay?

(See K10-12).

13. Cut public sector pay bill/administrative costs of central government?

Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on. Provision for public service pay increases next year limited to 4 per cent. Administrative costs ae not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain the drive for more efficient management throughout the public sector.

LOCAL GOVERNMENT

14. Overspending in 1982-83?

[Report in The Times 23 March suggests 6 per cent overspend]

Too early to say how much local authorities are budgeting above Government plans. But our plans are realistic; local authorities could achieve them (if they wanted to and tried hard enough. [IF PRESSED: Agree that preliminary results disappointing. Government's response will be announced in due course].

15. Large rate increases this year are Government's fault?

[CIPFA forecasts of 15 per cent reported in Press 17 March]

Not at all. If local authorities budget to spend in line with Government's plans, rate increases should be very low. Where they are high, it is because local authorities have chosen to overspend. [NB. FSBR quotes 12 per cent rise in rate income but this takes account of information so far received on actual rate increases.]

16. Cut staff numbers in local authorities?

Local authority manpower has been reduced by nearly 75,000 (over 4 per cent). Manpower reductions are key to achieving long term savings; bigger reductions required to achieve Government targets for LA current expenditure.

17. Government's plans for later years are unattainable?

[Press reports have claimed that White Paper implies 9 per cent total reductions in 1983-84].

Government's plans for 1983-84 are fair and realistic - they are 4 per cent higher than for 1982-83. [IF PRESSED: if this means that LAs are faced with need to make substantial economies, reason will be LA's overspending in 1982-83].

18. Effect of NIS reduction on local authorities?

As Chancellor announced in Budget the lower NIS payments by local authorities will be offset by a reduction in RSG. This will mean that local authorities overall are neither worse nor better as a result of the decrease in NIS. [IF PRESSED: we shall be consulting the local authorities about the details.]

19. Control of rates paid by industry

We certainly share the concern about harmful effect of high rates on business. But, unless local authorities cut their spending, any limit on rates has to be paid for by domestic taxpayer generally. However, we will be considering this further in context of longer term future of domestic rating system. Meanwhile, Government's continuing pressure on local authorities to reduce expenditure should help all ratepayers.

20. Green Paper on Domestic Rating System: Government response?

Government is considering carefully all representations received. We wish to produce proposals for a scheme that will remedy the shortcomings of the present system while commanding wide support.

F CIVIL SERVICE STAFFING AND PAY

[Functions being exercised by HM Treasury since 16 November 1981: (1) civil service manpower, pay and allowances, retirement policy and superannuation scheme, staff inspection and evaluation, (ie central allocation and control of resources), (2) responsibility for Central Computer and Telecommunication Agency and Civil Service Catering Organisation (3) civil service industrial relations. Functions being exercised by Management and Personnel Office (MPO): (1) civil service efficiency, personnel management, recruitment and training, (2) Office of Parliamentary Counsel (3) machinery of government questions.]

1. Civil Service too big/does too much/is over staffed?

Since the Government came to office, Civil Service has been reduced by nearly 8 per cent to 675,400. This is smallest for 15 years. This results from a reduction in functions, privatisation and improvements in efficiency. We are on course to achieve our aim of having a Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean the smallest Civil Service since the end of the war.

2. Current pay offer to Civil Service

After two negotiating meetings with the non-industrial Civil Service trade unions, no agreement reached. The dispute will be heard (by the Civil Service Arbitration Tribunal) on 19 April.

3. Government offer to Civil Service reasonable?

Basis of the offer is what is needed to recruit, retain and motivate sufficient staff of the right calibre. No justification for asking the taxpayer to do more.

4. Scott Report/Public sector pensions?

See K 18.

G SOCIAL SECURITY

1. November 1982 uprating?

[Chancellor in Budget statement announced that most benefits are to be uprated by 11 per cent next November - 9 per cent for price protection and 2 per cent to restore shortfall. Social Services Secretary gave details in statement 10 March.]

We have provided for benefits usually uprated to maintain their purchasing power and get back shortfall of 2 per cent which occurred at last uprating. This includes those benefits where we have given no pledge of full price protection. Uprating of benefits next November will cost £1 billion in 1982-83 (nearly £3 billion in full year).

2. Why not restore November 1980 5 per cent abatement now that unemployment benefit is to be brought into tax?

Decision to abate UB was not simply taken as a proxy for tax but to reduce public expenditure and to improve incentives to find and keep work. (Chancellor's Budget statement in March 1980 made that perfectly clear.) Those reasons remain valid. Any improvement on rates announced would seriously worsen incentives. Cost too would be high - £60 million in a full year [net of reduced claims for supplementary benefit, but gross of tax.]

3. Increasing supplementary benefits by less than forecast movement of prices hits at poorest of the poor, and breaks an election pledge?

The benefits will retain their value in real terms. Beneficiaries receive not only their scale rate entitlement but a cash payment to cover their housing costs in full. By uprating scale rates in line with RPI which includes housing costs, there has been some double provision. The change corrects that. The abatement of ½ per cent represents a broadly based adjustment for the likely relative movement of housing costs to November 1982. [NOTE: we do not want to make public a forecast of a housing index.]

4. Increase in capital disregard should have been greater?

[Increase in capital disregard for supplementary benefit from £2,000 to £2,500 announced 10 March.]

Change represents 25 per cent increase in level of disregard since it was set in November 1980; this more than restores its value. No reason to suppose that operation of the disregard causes any general hardship or that it has led to people deliberately disposing of capital in order to qualify.

5. Child Benefit increase too low?

[Increase of 60p to £5.85 in November.]

Uprating will maintain real value of the benefit since November 1980. Not as high in real terms as level set in April 1979, but the increase then is generally recognised to have been out of line - a pre-election move by last Labour Government.

6. Earnings Limit

Earnings limit for pensioners has been increased from £52.00 to £57.00. It remains our intention to abolish the limit entirely. But so far we have not been able to do so; it has been essential to give priority to maintaining purchasing power of benefits.

7. Death grant - increase to realistic level?

[Social Services Secretary announced 10 March intention to publish a consultative document on the death grant.]

Social Services Secretary would welcome comments on his consultative document on death grant which is to be published shortly. As we have always made clear, our aim is to redistribute the resources now devoted to death grant in a more sensible fashion - we cannot afford to add to those resources.

8. Why cut child dependency additions to unemployment benefit?

[In line with practice in recent years, uprated level of child dependency additions to unemployment benefit (but not Supplementary Benefit) has been abated by amount of increase in Child Benefit. In consequence, CDAs will be reduced from current level of 80p to 30p next November.]

The child dependency additions to unemployment benefit are being phased out, and will eventually be replaced entirely by Child Benefit. In this we are following practice adopted by last Labour Government.

H PUBLIC SECTOR BORROWING

1. PSBR in 1981-82 and 1982-83

[1982-83 FSBR published 9 March shows an estimated 1981-82 PSBR outturn of £10½ billion, and a forecast 1982-83 PSBR of £9½ billion.]

PSBR in 1981-82 in line with 1981 Budget forecast and PSBR reduction in 1982-83 broadly in line with 1981 MTFS.

2. Effect of Civil Service dispute on PSBR?

PSBR in both years affected by Civil Service dispute. In 1981-82 some £¾ billion of receipts delayed from March 1981 were collected but some £1 billion of receipts due in 1981-82 will now be collected in 1982-83. Debt interest cost of the strike some £½ billion in 1981-82.

3. CGBR April-Feb press notice implies odd CGBR for March?

[CGBR April-February £8.1 billion - PSBR estimates 1981-82 £8.75 billion.]

The borrowing figures in the FSBR are consistent with the outturn information available so far this year.

4. PSBR should be higher/lower?

The PSBR reduction in 1982-83 is broadly in line with 1981 MTFS. [IF PRESSED: PSBR 'broad brush' concept. Cannot adjust for every factor. Swings and roundabouts. Main criterion for judging appropriate size is scope for financing it without undue strain on interest rates.]

5. Government seeking credit for fall in PSBR from year to year by over-stating likely 1981-82 outturn?

No. £10½ billion still the best estimate for 1981-82 PSBR. There is normally a surge in borrowing in last quarter of financial year (LA's borrowing, other spending up).

6. Fiscal policy should be based on cyclically adjusted/real PSBR?

Some merit in inflation-adjusted measure as indicator of fiscal stance in some circumstances. But there are dangers here: it would be quite wrong to expand PSBR in cash terms in response to an upsurge in inflation merely to keep inflation-adjusted measure constant. Policies intended to eradicate inflation, not to adjust to it.

J MONETARY AND FINANCIAL POLICY

1. Lower interest rates?

[Bank base rates reduced by ½ per cent to 13 per cent with effect from 12 March. Have come down by 3 per cent from peak of 16 per cent last autumn. Market rates generally have been falling.]

Of course we want to see lower rates. But we must proceed cautiously if we are not to let up in the fight against inflation. Despite difficult conditions abroad, interest rates have fallen.

2. Will high and unstable US rates affect UK rates?

[FT 26 March highlighted remarks in BEQB about difficulties posed by rise in US interest rates].

US rates not sole determinant of UK rates, but high US rates certainly an adverse development and in September were a key factor in driving our rates up. Recently, however, sterling has remained reasonably firm, probably helped by improved prospects for wage round, and good trade figures. UK rates eased against US trend; but cannot insulate ourselves from difficult international background.

3. Recent fall in interest rates incompatible with strategy

Taking account of all evidence, present levels of interest rates are consistent with policy of continuing downward pressure on inflation.

4. MTFS being quietly shelved?

[3rd MTFS states Government's objectives "to reduce inflation and to create conditions for sustainable growth in output and employment", by "steady but not excessive downward pressure on monetary conditions". Key financial indicators are the monetary aggregates and exchange rate. Target range for growth of M1, £M3, PSL2 in period February 1982 - April 1983 of 8-12 per cent. Illustrative path of 7-11, 6-10 per cent in 1983-84, 1984-85. Targets for later years to be set nearer the time.]

No. Updated MTFS is realistic and flexible, describes how monetary policy operated in practice. MTFS serves useful purpose. Right to retain and adjust in light of experience.

5. Monetary targets discredited?

Monetary targets have important role in defining medium term direction of policy. But short term movements in monetary aggregates not always reliable guide to monetary conditions. Policy decisions based on assessment of all available evidence.

6. Increase in target ranges

Ranges in past MTFS were purely illustrative. Did not take account of structural changes. Right to take account of current rate of growth in setting new targets, to avoid unduly sharp brake on monetary growth. 8-12 per cent still implies deceleration from current growth rate ie continued downward pressure on monetary growth.

7. What if aggregates' rates of growth diverge?

Will examine factors underlying divergence. Policy decisions will continue to take account of all available evidence with a view to restraining inflationary pressures.

8. Overshoot of 1981-82 target

[Preliminary information suggests £M3 was little changed during banking February; rate of growth over past 12 months (ie the target period) was 14.4 per cent. M1 fell by about ½ per cent in banking February; grew by 8.7 per cent over past 12 months; PSL2 rose by about ½ per cent in banking February; grew by 12.1 per cent over 12 months.]

Growth in £M3 was above top end of target range, even allowing for effects of Civil Service strike. At least part of excess reflects lending. Also reflects longer term effects of institutional changes such as ending of corset, abolition of exchange controls and changes in savings behaviour. These factors imply higher monetary growth permissible for same increase in nominal incomes.

9. Monetary conditions too tight?

Behaviour of exchange rate and money GDP as well as monetary aggregates suggest financial conditions have been moderately restrictive as intended. But bank lending still high, despite level of interest rates. Companies' financial position much stronger than a year ago. (See P4)

10. Bank lending

Still very strong. Part at least is substitution for lending by building societies and other forms of consumer credit. To extent that it is additional, adds to inflationary pressure, it must avoid premature relaxation of interest rates.

11. Why more indexed gilts?

[Bank announced new index-linked gilt available to all investors on Budget Day. Restrictions on eligibility to hold existing indexed gilts removed.]

Issue of indexed gilts demonstrates Government's confidence in strategy of reducing inflation. Will allow direct access to indexation benefit to individual investors.

K PRICES AND EARNINGS

1. When will single figure inflation be achieved?

[Year-on-year rate of inflation 11 per cent in February, compared with 21.9 per cent in May 1980 and lowest recent level of 10.9 per cent in July 1981.]

Budget forecast is for year-on-year rate of inflation of 9 per cent by Q4 1982, falling to 7½ per cent by mid-1983.

2. FSBR inflation forecast more optimistic than major outside forecasts?

Many outside assessments do not yet incorporate full beneficial implication for inflation of Budget and lower oil prices. Assessments released since Budget expect single figure inflation to be recorded this year (LBS, P&D, Simon and Coats, St James). March CBI monthly trends enquiry shows, for second consecutive month, a substantial decline in net balance of firms expecting to raise prices in next four months [Dec and Jan 47 per cent, Feb 40 per cent, March 32 per cent].

3. Inflation still higher than when Government took office?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 14.1 per cent.]

Average level of inflation will be lower under this Government than under its predecessor. This will be the first Government since the war that has achieved a lower rate of inflation than its predecessor.

4. What reason is there to expect a further decline in inflation?

Over the next year or so, moderation in unit labour costs should continue to exert downward pressure on the rate of inflation, as should weak commodity prices. Competitive pressures on firms to limit price rises are also likely to remain strong.

5. Effect of 1982 Budget on RPI?

Compared with full indexation of excise duties, direct effect of Budget is RPI reduction of 0.1 per cent (or an increase of 0.1 per cent including also the direct effect of the 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 0.8 per cent increase in the RPI (or 1.4 per cent including also 2 December measures).] But this is less than increase arising from last year's Budget and hence will contribute to fall in the 12-monthly inflation rate.

18. Index-linked pensions and the Scott Report?

The Government is considering the whole question in the light of the Scott Report. Our aim is to ensure that public servants' pensions are fair to taxpayers, as well as to current employees and pensioners and their dependants.

6. Effect of 1982 Budget on TPI?

Compared with full indexation of excise duties, direct effect of Budget is TPI reduction of 0.4 per cent (or increase of 1.1 per cent including also direct effect of 2 December measures). [IF PRESSED on non-indexed basis: direct effect is 1.6 per cent reduction (or a 0.3 per cent increase including also 2 December measures).]

7. Nationalised industry prices

Nationalised industry price rises have been due in part to the ending of the previous Government's policy of artificial and distortionary price restraint. Rate of nationalised industry price rises generally is now coming more closely into line with the RPI. [See R15]

8. Current level of pay settlements?

In economy generally, settlements in last pay round averaged 8-9 per cent. Negotiators seem to be settling up to about a third lower in this round than they did in previous. And almost all settlements seem to be in single figures.

9. Private sector pay - the CBI's 7 per cent?

[CBI figures published 17 February suggest that manufacturing settlements monitored since 1 August are averaging around 7 per cent.]

Settlements have been lower in recent months, reflecting an increasing sense of realism about pay. But the need is continuing low settlements which are consistent with maintaining economic recovery and improving employment prospects.

10. Public sector pay

Government's approach to pay in the public services must take account of what the taxpayer can afford. Pay negotiations in the nationalised industries and local authorities are a matter for the parties concerned, as are the financial consequences of any settlements reached.

11. 4 per cent pay factor unrealistic/unfair?

Real incomes had risen to unsustainable level and public service pay increased relative to private sector since 1979. 4 per cent is broad measure of what Government thinks reasonable and can be afforded as general allowance in fixing the programme from which public service pay bill has to be met.

12. Nurses broken through the 4 per cent?

The 4 per cent factor is not a norm. Government recognises need for pay settlements to take account of market factors, including effect on recruitment and retention of expensively trained staff in NHS.

13. Average earnings index

[Year on year growth 10.8 per cent in January compared with 10.1 per cent in December, though (unpublished) underlying increase slightly less than in previous 5 months at just under 11 per cent.]

Recent buoyancy of earnings partly reflects increase in hours worked, which is an effect of the emerging revival of activity, particularly in manufacturing. Change over the 12 months to January straddles two pay rounds - not useful indicator of recent trends.

14. Comparison of TPI and index shows that real take-home pay has fallen over the past year

Yes. But follows growth of 17½ per cent in personal living standards in three years 1977-80.

15. Movement in TPI

Fact that TPI has been increasing faster than RPI (roughly 3½ per cent faster over year to February 1982) reflects measures taken to restrain Government borrowing -essential if inflation is to be controlled.

16. Government aiming to cut living standards?

[Latest (revised) RPDI figures suggest no further fall between Q2 and Q3 1981.]

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

17. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, evasion, administrative cost, and interference with market forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

L BALANCE OF PAYMENTS

[More trade figures may be published Friday 2 April.]

1. Balance of payments Q4 1981

Current account established to have been £1,541 million in surplus in Q4, including a visible trade surplus of £623 million. Total 1981 current account surplus £8 billion.

2. Invisibles

Q4 invisibles surplus in Q4 1981 is put at £918 million compared with £400 million in Q3. This reflects EC receipts totalling £531 million, including budget refunds of £118 million. Increase in the invisibles surplus for 1981 as a whole largely due to 18 per cent increase in interest, profit and dividends surplus to £1,148 million - demonstrating benefits from investing abroad.

3. Capital flows

Identified capital inflow in Q4 of £70 million. But the large 'balancing item' (£2,100 million) means that all Q4 figures should be treated with caution.

4. Trends in exports

Non-oil exports were 3½ per cent higher in volume terms than in 1980. Exports of intermediate and capital finished manufactured goods are now higher in both value and volume terms than in 1979 and 1980 despite loss of competitiveness. DoI survey of engineering industry suggests export deliveries will continue to rise in 1982, as does CBI Industrial Trends Survey.

5. Trends in imports

December import figures are in line with the average for the previous 3 months. The recovery in imports is across the board, including basic materials and manufactures used by UK industry. This is consistent with view that destocking is coming to an end and the economy picking up.

6. Prospects for 1982?

[FSBR projects surplus of £4 billion on current account, average margin of error is £2 billion. Outside forecasts range from near balance to £7 billion surplus.]

Very uncertain, but nearly all forecasts see continued surplus - albeit below last year's record level.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate

[Since last autumn sterling has remained broadly stable and is currently over 12 per cent below its effective rate peak early last year. Recent lows have been $1.77 on 14 September, DM4.07 on 20 October. Highs were $1.97 on 30 November, DM4.407 on 9 February. Rates at noon on 19 March were $1.7876; DM4.287 and an effective rate of 90.95. Reserves at end February stood at $23.4 billion, compared with $23.2 billion at end January.]

As Chancellor again made clear in his Budget, the exchange rate normally gives useful information on monetary conditions. While we have no target for the exchange rate, its effect on the economy and therefore its behaviour cannot be ignored.

2. Has the Bank intervened to support the rate?

The Bank intervene to smooth excessive fluctuations and preserve orderly markets. They do not seek to maintain any particular rate.

3. Concerted intervention to reduce the value of the dollar?

All the experience in recent years is that exchange rates for major currencies cannot be manipulated by intervention alone. Intervention can help to steady markets, but not counter major exchange rate trends. That takes changes in real policies, affecting interest rates, monetary conditions and fiscal policies. Lower US inflation is in everyone's interest: the matter for real concern is the US fiscal/interest rate mix, a problem all countries are familiar with.

4 Sterling should join the EMS?

[See N10-11]

5. Exchange rate and competitiveness?

Improvement in UK cost competitiveness in 1981 of over 10 per cent. This has been partly due to a decline in the exchange rate; more importantly because there are signs that our domestic unit labour costs are now growing more slowly than those of our major competitors. Wage costs per unit of output in manufacturing industry rose only 2½ per cent during 1981.

6. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to \$14 billion by end of 1981. This has been more than achieved - external debt is now around \$13½ billion, compared with over \$22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. <u>'Mandate negotiations'</u>

At meeting of Foreign Ministers on 23 March, Presidents of the Commission and Council put forward (on a personal basis) a possible arrangement for future refunds to the UK. Foreign Ministers greeted the proposals with interest, and agreed to study them further at meeting in Luxembourg on Saturday 3 April.

2. <u>Link with CAP prices?</u>

All member states agreed that the three chapters of the mandate must be taken together. The agricultural chapter and the budget chapter will therefore be carried forward in parallel.

3. <u>Net UK contribution to community too high?</u>

A lot lower than it would have been without the refund agreement of 30 May 1980.

4. <u>UK refunds in respect of 1981</u>

Commission have announced payments totalling £813 million for supplementary measures as first instalment of our refunds in respect of 1981. This represents 81 per cent of our entitlement for that year. Our net contribution for 1981-82 is now put at some £200 million - very substantially less than it would have been without the 30 May 1980 budget agreement.

5. <u>Lower Commission estimates of net contributions in respect of 1980 and 1981?</u>

Most recent Commission estimates suggest that our net contributions in respect of 1980 and 1981 will be significantly lower than expected at time of 30 May Agreement. That is very satisfactory. For we remain one of the less prosperous Member States.

6. <u>Budget refunds reduced if net contribution less than originally estimated?</u>

The UK is clear that minimum net refunds payable under 30 May agreement are 1175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

7. <u>Do supplementary measures grants lead to additionality?</u>

There is additionality in that refunds enable public expenditure in the regions and elsewhere to be higher than would otherwise have been possible.

8. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of the growth of guarantee expenditure.

9. Costs of CAP to UK consumers

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

EUROPEAN MONETARY SYSTEM

10. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

11. When will the conditions be right?

Sterling is an international financial currency and is also particularly affected by oil market factors. These mark sterling out from other Community currencies, and add to the difficulty of the decision on the timing of sterling's participation. The balance of advantages, risks and disadvantages is constantly changing, so that the question of participation remains complex.

P INDUSTRY

1. Budget does not do enough for industry?

Budget measures directed at helping business and will cost £1 billion in 1982-83. On indexed basis over 2/3 of Budget's net revenue cost will go to help businesses. But main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates.

2. Industry's response to Budget?

[Sir Raymond Pennock, CBI President - 'welcome fillip' to business confidence. Sir Terence Beckett, Director General CBI - 'moves in the right direction'. ABCC - 'insufficient and misconceived'. Saturday 13 March Financial Times Marplan survey of industry's reaction reports 77 per cent thought it 'fairly good' for the economy and half those polled thought would reduce inflation.]

Have noted the Association of British Chambers of Commerce's adverse comments, but pleased with the generally favourable response from industry, including CBI.

3. Prospects for industry-recovery?

Fall in output has now come to an end. Industrial production in Q4 1981 ½ per cent up on Q3 and some 2 per cent up on H1. Budget forecast suggests there may be 3 per cent increase in manufacturing output in 1982 as a whole. March CBI enquiry encouraging (see B3).

4. Company sector finances improved?

[Gross Trading Profits of industrial and commercial companies (ICCs) net of stock appreciation rose strongly in H2 1981 (up 23 per cent between H1 and H2) and were 10 per cent higher in 1981 than in 1980. Borrowing requirement of ICCs has improved over year to Q3 1981, and financial deficit turned into surplus. DOI's latest survey of company liquidity (published 5 March) showed that at the end of Q4 1981 liquidity ratio was lower than at end of Q2, although still well above mid-1980 levels.

Figures encouraging. Company financial position is in any case confused by effect of civil service dispute. After adjustment for stock appreciation and excluding North Sea, ICC profits have stabilised since mid-1980. Improvement in financial position partly reflects destocking and action to reduce overmanning.

5. Rate of return still too low?

[Real pre-tax rate of return of non-North Sea ICCs rose marginally to 2½ per cent in 1981 Q3 compared to 2¼ per cent in Q2 (a record low).]

Yes, but Government can only help in limited ways such as reducing burden of NIS and creating the climate for lower interest rates. Further improvements in ICC's profits and real rates of return can be expected, provided recent productivity gains and trend towards moderate settlements continue.

6. High interest rates damaging for industry and investment?

[Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.]

Budget measures have eased pressure on interest rates, and the recent ½ per cent fall in the banks' base rates is encouraging. But Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Continuing relatively high level of interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFS. (See brief J).

7. Government help for small firms

Budget provided further help for small businesses in addition to 75 measures taken previously. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme this year (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

8. Response to Loan Guarantee Scheme?

Scheme operating successfully. We have already issued more than 2,700 guarantees - well over half to new businesses. Total lending under scheme is just under £100 million. Ten new banks were admitted to the Scheme in November 1981: a total of twenty-seven financial institutions are now participating. Budget provided for the lending ceiling - in year to May 1982 - to be raised from £100 million to £150 million. A further £150 million will be made available in following year.

9. Progress with setting up Enterprise Zones?

Excellent progress being made. Ten of the eleven zones are already in operation. We expect the final zone - Isle of Dogs - to come into operation in late April 1982.

10. Response from private sector?

Response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

R NATIONALISED INDUSTRIES

GOVERNMENT RELATIONS WITH NATIONALISED INDUSTRIES

[Industry Secretary announced 15 March that Government is to change its dealings with nationalised industries by agreeing objectives with each, putting more emphasis on efficiency by increasing Monopolies and Mergers Commission references and through board structures, and by strengthening business expertise in Whitehall.]

1. Whitehall making a take-over bid for the industries?

A distinction needs to be made between monitoring and interference in management. It is crucial for officials and Ministers to be informed about the industries' progress and about any problems that arise; but equally there is no intention to interfere with the proper role of management within the industries.

2. Industries hostile?

Government's proposals have been discussed with the Nationalised Industries Chairman's Group. They support the objectives underlying the proposals and have made a number of constructive comments. But the changes will affect Whitehall as well as the industries.

EXTERNAL FINANCING LIMITS

3. EFLs for 1982-83 and future years?

Nationalised industries' total external finance increased by £1.3 billion in 1982-83, £1.7 billion in 1983-84, £1.2 billion in 1984-85 - a total of over £4 billion over the three years of the Survey. Government has given full recognition to problems faced by the industries in a period of recession. Increase in 1982-83 was roughly half what the industries bid for.

4. Unreasonable to reduce EFLs following NIS cut?

Reduction in the National Insurance Surcharge was designed to benefit private sector; not the intention that public sector should gain from it. Reduction in EFLs will simply offset the addition to the industries' internal resources following the NIS cut. No industries will be worse off than previously, and their plans should be unchanged.

5. Pay assumptions?

Government has not set pay or any other assumptions for the industries. Moderate pay settlements - and restraint of current costs generally - essential if investment programmes to be maintained and prices to consumers kept down.

6. External financing outturn for 1981-82 way over original limits?

During 1981-82, five industries had their external financing limits increased by a total of £0.5 billion, met from the Contingency Reserve. In granting these increases, Government recognised problems faced by some industries in a period of recession, and that, in some circumstances, EFLs could not be immutable. Not yet possible to make full assessment of ASLEF strike, but three industries in particular - National Coal Board, British Steel Corporation and British Rail itself - have been adversely affected in short term.

INVESTMENT

7. Investment plans for future years?

Overall, industries' investment plans on a rising trend. [CAUTION: Not true for each individual industry.] Increase in total planned expenditure on fixed assets since last White Paper is £200 million in 1982-83, £600 million in 1983-84 and £700 million in 1984-85, ie an increase of £1.5 billion over the three years. This implies total investment of no less than £24 billion over the three years. 1982-83 plans allow for 26 per cent more investment than in 1981-82, and 40 per cent more than in 1980-81.

8. How robust are the forecasts of nationalised industry demand/contributions to public expenditure, given the recent track record?

Plans just published are considerably less optimistic than those published last year, when the industries' plans assumed a return to near-total self-financing by 1983-84. In particular, in increasing substantially the external finance available to the industries in each year of the Survey the Government has recognised the effect of lower demand on the industries' internal resources, which are now expected to be well below the levels in last year's White Paper - by about £2 billion in each of the years 1982-83 and 1983-84. The industries' external financing needs are still expected to decline over the Survey period, but from a higher base and at a more gradual rate than forecast last year.

9. Investment plans unlikely to be attained?

No Government can unconditionally guarantee a level of investment by the nationalised industries. Approved levels set out in White Paper are consistent with the industries' agreed external financing requirements, on the basis of the internal resource forecasts they have prepared. But perfectly possible that the plans might need to be revised, for example if the industries fail to restrain their current costs, including pay.

10. But shortfall in capital spending 1981-82?

[Figures in FSBR imply shortfall of £¾ billion.]

Not easy to establish firm reasons after the event. Such evidence as we have suggests a mixture of reasons. Most important has been a cut in investment in response to changed circumstances such as lower market demand. These cuts have been extraneous and have not borne any direct relationship to EFL pressures. Other cuts have been for wholly beneficial reasons, such as lower than expected inflation and cost savings.

11. Take nationalised industry investment out of PSBR?

Real problem of pressure on resources cannot be solved by changing statisticval definitions. Since nationalised industries are part of public sector, their borrowing - for whatever purpose - must be definition form part of public sector borrowing requirement.

12. Private finance for NI investment?

[NEDC Working Party's study of nationalised industry investment was discussed at Council's 5 October meeting: agreed there should be review of progress to be completed by June 1982.]

We have indicated our willingness to consider new financing proposals. But direct market finance can only be justified if there is a genuine element of performance-related risk for the investor, in order to improve incentives to management efficiency, and if new forms of saving are tapped, so as to avoid adverse monetary consequences. Market financing does not of itself lessen burden on financial markets.

13. Does the Government propose to sell shares in BT?

[Front page FT Monday 15 March.]

Recent press reports are speculative. As the Chancellor announced in his Budget statement, detailed work is proceeding on the Buzby bond. The Government continues to examine ways in which market pressures could be brought to bear on nationalised industries, including BT.

14. Finance more nationalised industry investment by cutting current spending?

Yes. As in private sector moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries is bound to diminish if excessive pay settlements agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

NATIONALISED INDUSTRY PAY AND PRICES

15. Nationalised industries' prices

Nationalised industries' price rises have been due in part to ending of previous Government's policy of artificial and distortionary price restraint between 1974 and 1980. But since middle of 1980-81, gap between NI price increases and RPI has narrowed. Artificial price restraint would result in unacceptable increased burden on taxpayer and distortion of market forces.

[CAUTION: gap between NI and 'all items' RPI could widen again in near future. Factors include LT fare increases in spring, winter electricity discount scheme ending, dropping out of RPI of last year's double revalorisation of excise duties.]

16. Action in Budget to help industrial energy users?

Total benefit to industry estimated at £150 million in 1982-83 from measures in Budget (combined effect this Budget and last is £250 million over two years 1981-83), namely freeze on industrial gas prices from 1 April to end-1982; new tariff arrangements for largest electricity users (and continuation of arrangements on electricity prices announced last year); standstill till next winter on list prices for foundry coke; extension of boiler conversion grants scheme.

PRIVATISATION

17. What further sales expected?

Special sales of assets in 1982-83 are forecast at around £700 million and around £600 million in each of the later years. These figures are well above those in last White Paper. This reflects primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - which are to be made possible by Oil and Gas (Enterprise) Bill currently before the House.

18. Net figure for special asset sales this year?

[Public Expenditure White Paper showed net sales of only £50 million in 1981-82; latest estimate published in FSBR is -£100 million - ie £100 net purchases.]

The low net figure is the result of decision not to proceed with a further programme of advance oil sales in a weak market. The gross figure expected to be in line with the £500 million target included in the last White Paper, and will include the proceeds from Cable & Wireless, the sale of Amersham International Limited and the National Freight Company Limited, the sale of the Government's shareholding in the British Sugar Corporation, and further sales of motorway service areas long leases.

19. Government simply selling valuable national assets to achieve PSBR target?

Of course the cash is welcome, but benefits run wider than that. Not only will any future borrowing by these undertakings be outside the PSBR, so reducing burden on taxpayers, but the organisations concerned will be made more responsive to market forces and thus have greater incentives to improve efficiency.

20. Government running into heavy weather over sale of Wytch Farm?

The British Gas Corporation is complying with the Government's direction to sell its interest in Wytch Farm. It is too early to say when the sales will take place.

21. Special disposals programme just a subsidy for speculators?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices where shares first traded.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially where company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares.

S NORTH SEA AND UK ECONOMY

1. In view of recent falls in price of oil, why did HMG not reduce tax burden on North Sea oil producers?

[Budget tax changes included abolition of Special Petroleum Duty, increase in Petroleum Revenue Tax rate from 70 per cent to 75 per cent, and new system for advance payments of PRT (all from 1 January 1983), plus smoothing of PRT payments from July 1983 (this improves HMG's cash flow at companies' expense). Changes reduce the marginal rate of tax (from 90.3 to 89.5 per cent); involve slight fall in Government 'take' (no change 1982-83, costs £70 million 1983-84).]

Recognise need for tax structure robust to both falling and rising prices. Detailed study showed us that under new structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that new tax structure will provide more secure and stable regime.

2. Government has missed opportunity to simplify North Sea fiscal regime?

The oil industry has made it clear that it would not welcome a structural upheaval. Would create serious uncertainty and major transitional problems.

3. Impact of falling oil prices on Government revenues and Government strategy?

[PM warned in 23 February speech that limited room for manoeuvre in Budget.]

Other things being equal, lower oil prices will reduce Government revenues from the North Sea. Treasury has estimated that each $1 off the price directly reduces revenue, other things being equal, by £250 million in first year and £350 million in full year. But falling world oil prices are good for the world economy. We will benefit from that - not only from impact on activity, but also lower oil prices will help in reducing inflation.

4. Implications of OPEC production limitation agreement for North Sea oil prices?

Remains to be seen whether the agreement will hold, and whether world oil prices will harden as a result.

5. Benefits of North Sea should be used to strengthen the economy?

[FSBR projections (in money of the day) of Government revenues from North Sea: £6.4 billion in 1981-82, £6.2 billion in 1982-83, £6.1 billion in 1983-84, and £8.0 billion in 1984-85. Lower than last year's projections, principally because of downward revision to oil price expectations. Projections already incorporate fall to $31 a barrel for Forties oil. Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise before 1985.]

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

6. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

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

North Sea revenues are already committed. Setting up a special Fund would make no difference. More money would not magically become available. So the money for this Fund would have to come from somewhere else. This would mean higher taxes or lower public expenditure, if public sector borrowing is not to rise. If borrowing did rise, then so would interest rates. Not obvious that net effect would be good for investment.

8. Does HMG endorse conclusions of Bank of England article on North Sea?

[BEQB March issue.]

Broadly, yes. Useful contribution to debate. Agree that we are better off with oil -at current oil prices - than we would have been without it. We have been spared the fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil is costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for the possession of oil to require a contraction in our industrial ~~bade~~ base.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Government will have no choice but to reverse policies now unemployment has risen to post-war record levels in many Western countries?

Unadjusted unemployment exceeded 10 million in USA and 1 million in Canada in January. It exceeded 2 million in Italy in September, 2 million in France in October, and 1.9 million in Germany in February. Highest ever unemployment levels in Canada, France, Italy and UK and highest in USA and Germany since 1935.]

No indication of a widespread departure from consensus achieved last year (eg Ottawa Summit, IMF Interim Committee) about need for prudent fiscal and monetary policies to bring down inflation.

2. Anti-inflation policies not working?

[Year on ~~year~~ consumer price inflation in major countries fell to 8.9 per cent in January. Underlying ~~rates~~ falling in US. OECD and IMF expect some decline in 1982.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980: some decline expected 1982.

3. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

4. Other countries giving priority to reducing unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

5. Other governments not following such stern policies as UK?

[Most major countries (US, Japan, Germany, Italy, Netherlands, Belgium, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Belgian government has used its special powers to freeze prices temporarily and severely curtail wage increases for rest of 1982.]

Most governments persevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

6. UK is alone in Europe. Even Germany announced investment/employment scheme?

UK far from alone. Almost all European governments working to curb public spending, budget deficits and monetary growth. French government has set limit on its budget deficit for 1983 of 3 per cent of GDP. German government plans to reduce its borrowing in 1982 Budget even in nominal terms by almost 30 per cent. Unlikely investment/employment scheme will entail any significant increase in borrowing - increase in VAT (by 1 per cent to 14 per cent) part of the package from 1 July next year. Impact on employment remains to be seen.

7. Prospects for UK economy worse than for other countries?

No. Treasury and most independent forecasters expect UK growth this year of about 1½ per cent rising to an annual rate of 2 per cent by early next year. This is very closely in line with the OECD's forecast for OECD Europe. Unemployment is expected to rise in all major countries except Japan. UK inflation (GNP deflators) likely to be around the OECD average and below that in France, Italy and Canada.

8. Prospects for US economy?

[Industrial production rose 1.7 per cent in February after falling 2.5 per cent in January. Inflation in January was 8.4 per cent compared with a year earlier. Three-month interest rates lower than in February.]

Things are looking a little brighter in the US both on output score and, with lower interest rates, an improving outlook for inflation. And on the industrial relations front, there have been some encouraging settlements in which unions have clearly accepted lower wage increases in exchange for improved job security. [CAUTION: Not too much should be made of this: some upturn in US economy in the spring was expected.]

9. Even US using fiscal deficit to stimulate economy?

True US deficit is larger than anticipated. It is planned to fall but present level carries risk of prolonging period of high interest rates which could delay a European recovery. We strongly support the determination of the US authorities to combat inflation. But we believe fiscal and monetary policies must work together to that goal.

10. Recent international interest rate developments?

True that US interest rates rose earlier this year. But prime rates are well below their peak of 21½ per cent last summer (currently 16½ per cent).

11. Prospects for international interest rates?

Always difficult to forecast interest rates with certainty, but firm and balanced policies should over a period bring lasting reduction in both inflation and interest rates.

AIDE MEMOIRE ON THE UK ECONOMY 29 March 1982

PRESENT SITUATION

Most recent major outside forecasts (NIESR, P&D, CBI, LBS, St James) assess fall in output ended in H1 1981, with some recovery thereafter (in range 1-1½ per cent for 1982). ITEM and OECD are more pessimistic; seeing further falls of output into 1982. Year-on-year inflation is forecast by most groups to fall further to a range of 9-10½ per cent in 1982 Q4. Most groups see little possibility of further substantial reductions in 1983; inflation forecast to remain around 10 per cent in 1983. The March FSBR forecast, of a 1 per cent rise in output in 1982, and 10 per cent inflation in Q4 1982 is broadly in line with this consensus for 1982. FSBR sees 2 per cent rise in output in year to H1 1983; 7½ per cent inflation by Q2 1983. Unemployment (UK adult seasonally adjusted) forecast to reach around 3 million by end 1982, with some groups (P&D, LBS, Simon & Coates) expecting stabilisation in 1982, others expecting some further rise.

GDP output estimate rose in both Q3 and Q4 1981. Level in Q4 some 1 per cent above Q2. Recent months' industrial output figures affected by bad weather, car and rail strikes. Nevertheless, Q4 1981 manufacturing output some 2-3 per cent above low point in Q1 1981.

Consumers' expenditure rose about 1 per cent in Q4 1981: the overall level in 1981 was the same as in both 1980 and 1979. Retail sales were virtually unchanged in the 3 months to February 1982. The volume of visible exports in Q4 1981 was at a higher level than at any time since early 1980. The volume of visible imports in Q4 1981 was back to the level of the first half of 1980 and 21 per cent higher than Q1 1981. DI investment intentions survey conducted in October/November suggests volume of investment, by manufacturing, distributive and service industries (excluding shipping) will rise by about 2 per cent in 1982 following a fall of about 5 per cent in 1981. A large rise is tentatively expected in 1983. Investment by manufacturing (including leasing) is expected to rise during 1982, but for the year as a whole it is likely to be 1 per cent lower than 1981. An appreciable rise is expected in 1983. Manufacturers', wholesalers' and retail stocks dropped by £25 million (at 1975 prices) in Q4 1981 the smallest quarterly fall in the last two years of continuous destocking.

Unemployment (UK, seasonally adjusted excl, school-leavers) was 2,822,500 (11.8 per cent) at March count, up 5,000 on February. Vacancies were 110,600 in March.

Wholesale input prices (fuel and materials) rose ½ per cent in February; however the year-on-year increase fell to 12 per cent. Wholesale output prices rose ¾ per cent in February and are 10½ per cent above a year ago. Year on year RPI increase fell to 11.0 per cent in February. Year-on-year increase in average earnings was 10.8 per cent in January. RPDI was flat in Q3 1981 following falls in the previous two quarters and a 17.5 per cent rise over the 3 years 1977 to 1980. The savings ratio rose 1 per cent to 14½ per cent in Q3 1981.

PSBR £9.7 billion in the first three quarters of 1981-82 and CGBR (unadjusted) £8.1 billion in eleven months to February 1982; but both distorted upwards by the civil service dispute. Underlying PSBR for '81-82 believed in line with 1981 Budget forecast (£10½ billion).

Sterling M3 was little changed in banking February.

Visible trade showed a surplus of £0.6 billion in Q4 1981. Current account surplus of £1.5 billion in Q4 1981; likely surplus of £8 billion in 1981 as a whole. Reserves at end-February rose to $23.4 billion. At the close on 26 March the sterling exchange rate was $1.7870: the effective rate was 90.9.

PART 14 ends:-

E (82) 35 26/3

PART 15 begins:-

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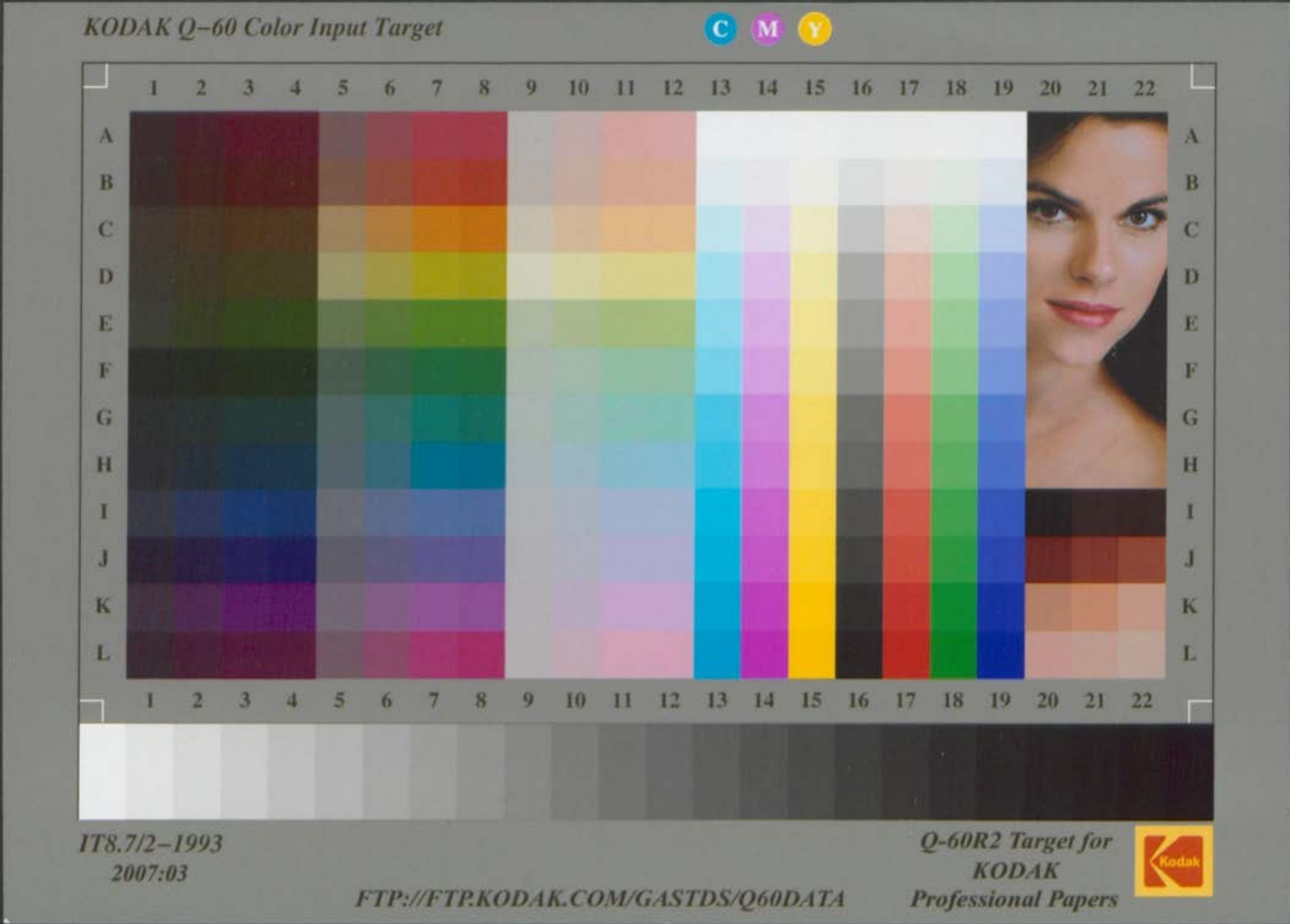
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