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The premature disclosure of the OECD Economic Outlook.

ECONOMIC POLICY

DECEMBER 1980

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OECD WP3 MEETING, PARIS

TELEGRAM NUMBER

A/ McMahon (Chairman) recalled the changes that had taken place in the world economy since the last meeting. The price of oil had fallen. There had also been some important changes in exchange rates. These included the EMS realignment, strengthening of the US dollar and a surprisingly weak situation for the Yen. The deutschemark was also probably below trend. This implied that US competitiveness was out of line, as was that of Japan and Germany. Real interest rates had persisted unusually high for a time of weak activity. Recovery of output had been less than expected but inflation had slowed more.

McMahon suggested that WP3 should concentrate its attention on the questions raised in the Secretariat's paper (CPE/WP3(82)1). Did US interest rates cause policy problems through exchange rate movements for countries outside the US? Why were real interest rates high? What were the implications of the changes in competitiveness brought about by recent exchange rate changes?

Japan

FUJINO

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Fujino (Japan) said that growth in the Japanese economy had been less than expected. He blamed high overseas interest rates (which prevented Japan reducing its own rates) and the prolonged deflationary effects of high oil prices. Nevertheless the rundown in stocks was finished and he expected investment to recover. He said the current surplus largely reflected the fall in oil imports. The slowdown in exports in November was expected to continue. Japan's capital outflow was larger than its current surplus, reflecting high overseas interest rates. The yen had fallen until mid-February but was now rising against the dollar. It was also strong against the European currencies, and was expected to appreciate in future.

He ruled out fiscal measures to stimulate domestic demand. Fiscal reform to reduce the deficits as a firm commitment of the government. The yen exchange rate had not been manipulated to boost exports. An appreciation would be welcome to improve real incomes and stabilise prices. But it was impossible to maintain stable rates in present circumstances. Timely and appropriate intervention with other countries would help to avoid disorderly movements. A change in policy mix towards a more relaxed fiscal policy and tighter monetary policy would not be acceptable, both because of political commitments and because of the risk of renewed inflation and loss of confidence in the yen.

Wallich (US) said that Japan's high savings were not being absorbed domestically. They must therefore be offset by capital exports or budget deficits. Capital exports however implied a depreciation of the yen and problems for the rest of the world. Wouldn't a larger budget deficit be preferable? Foreign exchange reserves had risen in the past year - partly reflecting interest earnings. Why not let these be put through the market and help raise the yen? Lamfalussy (BIS) stressed that government borrowing in Japan was a low proportion of savings. Couzens (UK) drew attention to the large share of GDP growth accounted for by external demand.

FLANDORFFER

Flandorffer (Germany) said that the yen exchange rate was the most important way of tackling the balance of payments problem. But the only way to influence the yen was through interest rates. Was it really so important for the recovery of domestic demand to have such low interest rates? Jurgensen (France) supported the need for a different fiscal/monetary policy mix. Sprinkel (US) welcomed Japan's recent reduction in tariff and non-tariff barriers but suggested the effect on imports was likely to be rather nominal.

Ogata (Bank of Japan), replying, said it would be difficult to contemplate a higher fiscal deficit. Amortisation of the accumulated deficit was going to be a heavy burden in the mid-to late 1980s. Government bond issues were already a heavy weight on the financial markets accounting for 85% of new issues. It would be difficult and impracticable to raise interest rates in Japan because of the weakness of smaller firms. Real interest rates were still positive.

Germany

Gleske (Bundesbank) said the current account had moved into a satisfactory position since October and was expected to be in balance in 1982, but most of the increase in exports had been to OPEC markets which were expected to weaken as the oil price fell. German imports had been low due to oil savings and low domestic demand. They should pick up as activity recovered. German competitiveness had improved against the US and in third markets but had worsened against other EC countries. The devaluation of the Belgian franc was likely to reduce demand for German goods. Germany would be happier with a strong deutschmark against the dollar so that interest rates could come down. He was sceptical about a system of two-tier interest rates.

Wesselkock (Finance Ministry) said some increase in output was expected and GDP might grow at about $2\frac{1}{2}$ per cent a year up to 1986, but unemployment would remain at 1.7 million. Growth of 5%

A YEAR

a year would be needed to return to full employment.

Ostry (Secretariat) said that Germany's growth had been even more export-led than that of Japan. How could more domestic demand be achieved - by lower interest rates? Fujino, disengenuously, asked whether German budget policy could be more flexible in the short-term.

Wesselkock said a fall in unemployment would require a better investment climate which implied lower real interest rates and a lower budget deficit. Flandorffer said the budget deficit could not be raised because of its adverse effect on confidence. Germany was a more open economy than Japan.

United States

Sprinkel (US) gave a reasoned defence of the US budget. He emphasised that public expenditure in FY1983 was only projected to rise by $4\frac{1}{2}$ per cent (although this might need to be revised upwards). The deficit, therefore, reflected reduced revenue. Including off-budget items it would be $127 billion in FY1983 - lower than FY2982. The deficit was too large but it was difficult to reduce quickly. The President would not abandon his tax cuts nor the projected increases in defense spending, but would listen to Congressional suggestions for other spending cuts. The deficit was not as high as a percentage of GNP as in 1976.

US interest rates were below their 1981 peaks and Sprinkel believed that they would continue to fall. They reflected a 3-4 per cent real return on capital, an inflation premium and an uncertainty premium. The Administration needed to establish credibility that it would reduce inflation. The Fed's control of the money supply and the recent reduction in price inflation were encouraging signs. People were moving out of speculative assets such as property and gold into financial assets. The next move would be into real investment.

Wallich said countries outside the US now had an opportunity for more flexible interest rates. The Fed's M1 target assumed a rise

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in velocity, helped by financial innovations. The increase in M1 in the first quarter was now unwinding. Fratianni (Council of Economic Advisers) said that GDP was expected to fall by 0.6 per cent in 1982. The fall in the first quarter was expected to be about 3 per cent at annual rate, followed by increase of 1 per cent in the second quarter and rises of 4 per cent at an annual rate in the third and fourth quarters.

Lamfalussy asked about the Fed's control techniques Jurgensen asked whether the Fed attached greater importance to M1 or the wider aggregates. Languetin (Switzerland) suggested that the Fed should have an interest rate target.

Wallich acknowledged the difficulty of controlling monetary growth. He said that the Fed attached importance to M1 because it was largely transactions balances. M2 and M3 included some savings, and one could not control the economy by controlling savings. He ruled out an interest rate target on the grounds that the Fed did notknow what the right level of interest rates should be.

Ostry and Couzens both stressed that high real interest rates probably reflected the uncertainty about fiscal policy. Sprinkel acknowledged the problem, but said that if the Fed and Administration "hung in", inflationary expectations would be reduced.

United Kingdom

Couzens described the main features of the UK budget. This was within the medium-term counter-inflation strategy. The public sector borrowing requirement would be reduced as a percentage of GDP. The principle of a declining growth for the money supply was also being retained but was being reshaped to include not only £M3 but also M1 and PSL2. The Government would also look at the exchange rate. The direct and indirect measures tax measures were broadly offsetting. The main thrust of the measures was to help industry, particularly the reduction in the NIS.

The slowdown in inflation has been delayed by last year's depreciation of sterling, but the rate of increase in prices should fall below 10 per cent by the end of 1982. GDP was expected to grow by about $1\frac{1}{2}$ per cent this year. The current surplus was projected to decline.

Sprinkel was worried that the money supply targets were becoming more discretionary. Would the Government merely draw attention to the one which it happenedto be hitting at any one time? Rieke (Bundesbank) asked what the Government's exchange rate target was. Couzens, in reply, said that the three monetary aggregates had tended to run together in the long run. When money was shifting between aggregates it was important to look at all three. The Government would not necessarily average them, but would try to interpret them. The exchange rate should be regarded as an indicator of monetary conditions but the government did not have a target for it.

OPEC Trade Study

The second morning was given over to a discussion of the Secretary General's Trade Study. Marris (Secretariat) introducing the discussion, said it was important to distinguish how far domestic regulations, industrial policies and export credit were doing duty for tariffs. It was important also to ask whether changes in the exchange rates themselves, stimulated protectionist pressures. He hoped in particular that the US could resist pressures for protection.

The two-way interaction between trade policies on the one hand and exchange rate and monetary policies on the other was emphasised by Wesselkock. Sprinkel stressed that poor macro-economic policies would make it difficult to follow liberal trade policies. Couzens said that although it was right to consider the implications of exchange rate changes for industrial policy, this was not the sole role of the exchange rate. When countries were following counter-inflationary policies, the exchange rate

WAS

was likely to appreciate as part of the process of changing fundamentals.

Several speakers stressed the need for better cooperation between the OECD, IMF and GATT referring in particular to the IMF surveillance role. Hood (Fund) said the Fund was conscious of the risk of protectionism and reported regularly on members' trade policies. It was anxious to explore how cooperation with the OECD could be improved. Several speakers mentioned the need to include trade in services and agricultural products. The need to integrate these newly industrialising countries into the open trading system was also stressed.

The danger of competitive devaluations was mentioned by the Netherlands and France.

The Chairman said he would circulate quickly a record of the working party's views, without trying to achieve agreement.

Chairman's summing up

The chief feature of McMahon's summing up of the two days discussion was his suggestion that the general view of the working party was that Japan's fiscal and monetary mix needed to be changed. He drew an analogy with the need for change also in US policy. The working party recognised the political difficulties in both countries, but if policies were not brought into better balance there was a risk of national measures in other countries and of protection. The Japanese made a final defence of their position and Sprinkel came to their rescue dissenting from the general view. He said the Japanese had reduced their fiscal deficit and monetary growth - just what any other country is trying to do. His own quarrel was with Japan's trade restrictions.

The next meeting was arranged provisionally for 8-9 July. The subject will be recycling, including international indebtedness and the implications of lower oil prices.

CARRINGTON

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Sir Kenneth Couzens KCB
Second Permanent Secretary
Overseas Finance

28 October 1981

M Scholar Esq
No 10 Downing Street
LONDON SW1

Dear Michael

POLICY ON PUBLIC DEFICITS IN OTHER COUNTRIES

As promised, I attach the table from the OECD Economic Outlook for July 1981 about which we spoke. As you know, I do not believe that these figures tell a comparable story about public borrowing in the seven countries. They are particularly misleading for countries with a big public sector or a high degree of de-budgetisation like France, the United Kingdom and Italy. And their inflationary significance depends on relative savings habits in the different countries. If the Prime Minister were challenged about international comparisons, I suggest she might reply as follows.

Any informed person knows that a simple comparison of Government deficits between countries can be misleading. It often takes no account of different sizes of public sector, different institutions and different savings habits. What is significant is that the United States, Japan and Germany, like ourselves, are all trying to achieve a reduction in public borrowing in 1982 compared with 1981. Holland and Australia are doing the same. When the Opposition tried in 1974-75 to prove to the world that this country under their policies was the only one in step, they fell flat on their face.

I am not sending the OECD table about the changes in real weighted budget balances. It is too complicated at this stage.

Yours ever

Ken

K E Couzens

Table 14
General government financial balances
1978 - 1982[a]

Surplus (+) or deficit (−) as percentage of nominal GNP/GDP

	1978	1979	1980*	1981*	1982*
United States	0	+0.5	−1.2	−0.8	−1.2
Japan	−5.5	−4.7	−3.9	−3.0	−1.9
Germany	−2.7	−2.9	−3.5	−4.5	−4.8
France	−1.8	−0.6	+0.4	−0.8	−0.9
United Kingdom	−4.2	−3.2	−3.5	−2.3	−1.0
Italy	−9.7	−9.4	−7.8	−8.4	−8.7
Canada	−3.1	−1.8	−2.3	−1.4	−0.8
Total of above countries[b]	−2.5	−1.9	−2.4	−2.3	−2.2

a) On an SNA basis except for the United States the United Kingdom and Italy which are on national income account basis.
b) 1979 GNP/GDP weighted.
* OECD forecasts.

Prime Minister (2)

Extract From 'The Times'
on Wednesday 28 October 1981 MLS 28/10

Business News

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OECD report

Sharp rise in UK taxes

By Frances Williams

Taxes rose more sharply in Britain last year than in any other leading industrialized nation, according to new estimates published by the Organization for Economic Cooperation and Development (OECD).

Between 1979 and 1980 tax revenues, including social security contributions, as a proportion of national output, jumped two percentage points from 34 per cent to 36 per cent.

Of the 23 OECD member nations listed only two small countries, Portugal and Ireland, suffered bigger tax rises than Britain.

But Britain is still less heavily taxed than many other countries, coming eleventh in the OECD rankings in both 1979 and 1980.

Sweden tops the list with a tax take amounting to half its gross domestic product (at market prices). By contrast, taxes in Japan account for only a quarter of gdp.

United Kingdom taxation is now higher than in 1978, the last year of the Labour Government, when it represented 34.5 per cent of gdp. And this year it is certain to surpass even the 37 per cent peak reached under Labour in 1975.

In his March budget the Sir Geoffrey Howe, Chancellor of the Exchequer, introduced swingeing tax increases to curb burgeoning Government borrowing.

He pushed up excise duties on beer, tobacco and petrol; and refused to raise income tax allowances in line with inflation, at the same time as national insurance contributions went up.

As a consequence, the direct tax burden on people in work is likely to climb to record levels this year. Only the very highest paid are paying less than when the present Government came into office pledged to sweeping tax cuts. The biggest increases have been suffered by the worst paid.

Nor is there any prospect of a substantial reduction in taxes over the next couple of years. Budget projections made last March suggested that the Government might have room to cut taxes in 1982-83 by about £1,500m (equivalent to about 2p off the basic rate of income tax), with a similar cut the year after.

As the Treasury admitted at the time, this would do no more than give back the extra taxes paid this year, let alone compensate for the earlier jump in the tax burden.

It now seems clear that even cuts on this modest scale may prove impossible without extra Government borrowing, because the Chancellor is not going to get all the cuts in public spending he wants next year.

So the Government, for all its election promises, could well go into the next election with taxes substantially higher than when it took office.

Taxes as a proportion of gdp could, on some estimates, rise to 40 per cent this year, the highest level for many years.

TAX REVENUE

Total revenue as percentage of gross domestic product*

	1979	1980**	change
Sweden	50.3	49.9	−0.4
Netherlands	47.4	46.2	−1.2
Luxembourg	46.2	47.6	+1.4
Norway	46.1	47.4	+1.3
Belgium	44.7	42.5	−2.2
Denmark	44.1	45.1	+1.0
Austria	41.4	41.5	+0.1
France	41.2	42.5	+1.3
Germany	37.3	37.2	−0.1
Finland	35.0	34.5	−0.5
Utd Kingdom	34.0	35.9	+1.9
Ireland	33.8	37.5	+3.7
United States	31.3	30.7	−0.6
New Zealand	31.2	n.a.	n.a.
Switzerland	31.1	30.7	−0.4
Canada	31.0	32.8	+1.8
Italy	30.1	n.a.	n.a.
Australia	29.8	n.a.	n.a.
Greece	27.7	n.a.	n.a.
Portugal	25.8	29.8	+4.0
Japan	24.8	25.9	+1.1
Spain	23.3	23.2	−0.1
Turkey	20.8	n.a.	n.a.

* Ranked by 1979 figures
** Provisional Estimates
n.a. Not available

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CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Ryrie
Mr Burns
Mr Middleton
Mr Downey
Mr Hancock
Mr P Dixon
Mr Kemp
Mr H P Evans
Mr Cassell
Mrs Hedley-Miller
Mr Bottrill
Mrs Gilmore
Mr Peretz
Mr Turnbull
Mr Ridley
Mr Cropper
Mr Lankester (No. 10)
Mr Dicks-Mireaux (Bank)
Mr D Curran (FCO)
Mr Anson (Washington)
Mr Baker (Paris)

cc Prime Minister

Prime Minister

A foretaste of the OECD annual survey of the UK, which looks reasonably helpful (see conclusions at Flag A)

TL 2/8

OECD SURVEY OF THE UK: JULY 1981

This annual survey of the UK will not be published until 14 August, but copies have already been released to the press under embargo and it is possible (bearing in mind the unfortunate experience with the Economic Outlook last Christmas) that "leaks" may occur.

2. As you know, Mr Kemp, Mr Evans and I attended the OECD's annual examination of the UK in Paris during the last week in June. Following these meetings, and further exchanges with the OECD Secretariat, most of our difficulties with the text have been resolved. There remain a few areas (notably the detailed section on monetary policy and, to a lesser extent, the sections on inflation and fiscal policy) where we were unable to persuade the Secretariat to take all our suggestions on board. In the main, these differences of view affect the analysis of past trends and developments (eg in the monetary statistics) rather than the discussion of prospects or policies. And the press are likely to focus attention on the conclusions to the report (copy

attached at A), which were strengthened following our meetings in Paris and are fairly enthusiastic about the general thrust of UK policies. In particular, the conclusions:

- support the present stance of monetary and fiscal policy: "... the authorities will have to maintain a relatively tight and steady macro-economic policy stance over the medium term. This is in line with the agreement reached by OECD Ministers in June 1981 on the need for medium-term monetary and fiscal policies which are non-accomodating of inflation";

- stress the need to "improve competitiveness and raise profits, the latter entailing a substantial shift of real resources to the corporate sector". A lower exchange rate is not the answer to falling competitiveness which requires "a marked reduction of wage settlements coupled with rising productivity"; the report also argues for further use of fiscal policy to switch resources into the corporate sector;

- argue for achieving "a closer dialogue with the social partners not only on pay but in the whole area of working practices and economic performance generally";

- while the forecasts published with the report suggest "a modest recovery in activity is probable" in 1982, any lasting recovery "also depends on whether the improvement in productivity can be sustained and built on". This would require "further reductions in overmanning and restrictive business practices and on getting acceptance by the social partners of new and internationally competitive methods of work".

3. Slightly on the negative side, the report hints at inflexibility in UK policy - "changing circumstances may .... require adjustments ... to the policy strategy". In particular it would like to see the composition of public spending reconsidered "to create room for higher public investment of the type which would contribute to private sector productivity growth".

4. A section of the report deals with short term economic forecasts (see table attached at B). This assessment is very similar to that published in the July edition of the OECD's Economic Outlook. The forecast is broadly consistent with the FSBR, and lies around the centre of the range of major outside forecasts. There is some (½ per cent) growth in GDP in 1982, mainly built on a recovery in stockbuilding (Government consumption, fixed investment and net trade all continue falling). UK unemployment (including school leavers) rises to 13 per cent (over 3 million) by 1982 H2. Inflation (as measured by the 12 monthly increase in the consumer expenditure deflator) falls gently into single figures during the course of next year. It should be stressed, however, that the forecasts are based on an unchanged exchange rate assumption, taking as the starting point an average rate in April-May 1981. Since then there has of course been a further depreciation in the pound, which will have ramifications both for the inflation outlook and other aspects of the assessment. The document stresses (p. 45) that the forecasts are by the Secretariat; there is therefore no question of an endorsment by the Treasury or the UK Government.

Line to take

5. Ministers, while wanting to avoid being drawn into detailed comment, might welcome the general conclusions of the report. The following further points might be made:

a. Though the Treasury was consulted about the report at its various draft stages, and officials gave evidence to the EDRC during the annual examination on 29 June, the document is entirely the responsibility of the OECD's Economic and Development Review Committee, comprising representatives of all the member countries.

b. The report endorses the central policy aim of maintaining "medium term monetary and fiscal policies which are non-accomodating of inflation". Its conclusions are consistent with the Ottawa and OECD ministerial communiques, and the recent reports by the IMF and BIS.

c. It stresses the need for further moderation in pay settlements, and improved productivity, so as to reverse the decline in industrial competitiveness. Fiscal policy also has a role to play in channelling more resources to the corporate sector.

d. It encourages a "closer dialogue with the social partners".

e. The forecasts published with the report, which are the responsibility of the Secretariat and not the EDRC, see some recovery in output next year and declining inflation. They are broadly in line with the FSBR, and lie around the centre of the range of major outside forecasts.

R.A

R I G ALLEN
EB
7 August 1981

A

surplus on invisibles in real terms is forecast to continue to decline. In total, the non-oil real foreign balance may impart a strong negative contribution to GDP growth during the forecast period (Table 16), but it will be dampened by an improvement in the real oil balance associated with a moderate but steady rise in North Sea oil production[68].

The forecast change in the real foreign balance largely explains the weak development of real GDP which after falling in the second half of this year should recover slowly through 1982. Although starting from a considerably lower level than real GDP, the recovery in manufacturing production is expected to be somewhat stronger, but by the end of the forecast period to be at a level of over one-fifth below the 1973 peak. The decline in GDP for nearly three consecutive years and its lagged effects on the labour market should lead to a further (albeit at a progressively slower rate) decline in employment. After the marked fall in productivity in 1980, a pick-up is expected from now onwards, particularly in manufacturing. The unemployment rate[69] could rise to about 13 per cent by the end of 1982 compared with about 11 per cent in mid-1981.

On the basis of a stable effective exchange rate, there should be a further small improvement in the terms of trade up to the end of 1982, but less so than was experienced up to the end of 1980. And in order not to worsen further the competitive position, profit margins in exports are likely to remain depressed. Under these conditions, the terms of trade improvement will be more than offset by the deterioration in the real foreign balance. There is also expected to be a further small increase in invisible payments associated with North Sea oil operations. Accordingly, the current account is forecast to move into small deficit by 1982, despite the growing slack expected over this period.

V CONCLUSIONS

A favourable feature of economic performance over the past year has been the marked reduction in inflation from a year-on-year rate of 22 per cent in the second quarter of 1980 to a rate of less than 12 per cent in the second quarter of this year. This improvement stemmed partly from the sizeable appreciation of sterling — which in turn reflected partly the commitment to the tight monetary strategy — and the related severe squeeze on profit margins. Since the autumn of 1980, the level of wage settlements has also substantially fallen reflecting both the deceleration in price rises and the increasing slack in the economy. Another encouraging feature has been the reported reduction in the private sector of overmanning, restrictive labour practices and other market rigidities which have hampered industrial performance in the past; so far, however, the effects of these changes on productivity have been masked by the cyclical decline in output.

Despite these favourable features of economic performance, however, the outlook for the next eighteen months — the period covered by the Secretariat's forecasts — remains difficult. On the fiscal and monetary policies discussed in

68 The contribution of North Sea oil to real GDP growth may be less than $\frac{1}{4}$ percentage point in both 1981 and 1982 compared with $\frac{3}{4}$ percentage point on average in the five years to 1980. Oil, as well as the other national account items, is valued at 1975 prices. On actual oil price levels the contribution from the rise in North Sea oil production will be around $\frac{1}{2}$ per cent of GDP both in 1981 and 1982.

69 United Kingdom, including school leavers as a per cent of total employees.

Part III above and the exchange rate and other assumptions on which the forecasts are based, a modest recovery in activity is probable. Unemployment, nevertheless, seems likely to continue to rise though at a slower rate than in 1980 and business fixed investment to fall despite some inprovement in corporate profitability. Also, the current external account may move into deficit again; as destocking comes to an end, import volumes are expected to rise considerably while export volumes may continue to fall due to the weak growth of world trade and a loss of export market shares of around 20 per cent in 1981 and 1982 taken together. At the same time, further deceleration in the rate of inflation may be relatively small.

The authorities would thus seem to face a major dilemma of how to achieve a continuing reduction of inflation and renewed expansion of activity of sufficient strength to generate a recovery in productive investment and employment. Such a conflict is common in most Member countries but it would seem to be more marked in the United Kingdom than generally elsewhere, given the substantial loss of external competitiveness over the last two years and the depressed profit position in industry. Accordingly, it is necessary to improve competitiveness and raise profits, the latter entailing a substantial shift of real resources to the corporate sector. A lower exchange rate would help in these respects but it would have unfavourable effects on import prices and be inimical to progress in reducing inflation. The achievement of better competitiveness compatible with a rebuilding of profits and a further easing of inflationary pressures will therefore require a marked reduction of wage settlements coupled with rising productivity. Indeed, without a substantial change in both wage settlements and productivity, a worthwhile improvement in competitiveness would not — at current exchange rates — occur or at best be very protracted with important implications for exports, investment and employment.

The greater realism in private sector pay bargaining evident in the recent period is encouraging although the level of pay settlements has not yet come down enough to reverse the deterioration in unit labour cost competitiveness. The extent to which further pay moderation will take place is, however, uncertain; it remains to be seen whether pay determination practices have basically changed and inflationary expectations reduced. Moreover, over the past year, the deceleration in pay settlements was preceded by a slowdown of inflation — helped by the appreciation of sterling — so that real wages continued to rise. In fact, in the period ahead real wages will need to fall if the pressing need for a shift of resources to the corporate sector is to be realised. Over the last three years real average earnings and real personal disposable incomes have risen by 15½ and 17½ per cent respectively compared with a rise in real national disposable income of 7½ per cent, entailing a decline in profits[70] to their lowest post-war level; indeed, the major part of the benefits of North Sea oil has been reflected in consumption. Thus, while further moderation of pay settlements is essential to improve the performance of the economy, it may at the same time be more difficult to achieve. Accordingly, it would seem desirable to consider whether the requirement of reducing pay settlements could be enhanced by achieving a closer dialogue with the social partners not only on pay but in the whole area of working practices and economic performance generally.

In these circumstances, the authorities will have to maintain a relatively tight and steady macro-economic policy stance over the medium term. This is in line with the agreement reached by OECD Ministers in June 1981 on the need for medium-term monetary and fiscal policies which are non-accommodating of inflation. Changing circumstances may, however, require adjustments — as in

70 Real disposable incomes of companies outside the oil and financial sectors.

1980 — to the policy strategy. Subject to further progress in reducing inflation and depending on interest rate developments abroad there may be some further room for reduction of interest rates. Moreover, the efforts made to reduce the growth of public expenditure have fallen heavily on public investment which has declined sharply in recent years. A continuation of this trend could hamper the functioning of the economy over the medium term. Accordingly, it is important to reconsider the composition of public expenditure to create room for higher public investment of the type which would contribute to private sector productivity growth. It is desirable to ensure that the financial position of the public sector is brought into better balance and that the resources thereby released are used as far as possible to improve the financial position of enterprises in the non-oil, non-financial sector.

It was argued in Part II of this Survey that the expected recovery in output in 1982 should be reflected in a cyclical rise in productivity. The recovery of the economy also depends on whether the improvement in productivity can be sustained and built on. There is a large reserve of potential productivity gains in manufacturing and services as a result of the relatively high level of investment in plant and machinery in the past. This potential will have to be realised if worthwhile progress in reducing inflation and improving competitiveness is to be achieved and if there are not to be further business closures. The extent to which this will occur seems likely to be heavily dependent on further reductions in overmanning and restrictive business practices and on getting acceptance by the social partners of new and internationally competitive methods of work.

B

during the forecast period but remain at a high level. To sum up, investment in manufacturing and distribution and services is forecast to be by the end of 1982 at about the 1978 level.

Table 16 The outlook for 1981 and 1982
Annual percentage change from previous period

	1980	1981	1982	1981 I	1981 II	1982 I	1982 II
Private consumption	¾	−½	¼	2	−3	1¼	1½
Government consumption	1¼	½	−¾	–	−¾	−1	−½
Fixed investment	−2¼	−7¾	−2	−10	−3½	−2¾	1
Public	−5¼	−11½	−2	−17	−1	−2	−2
Private	−½	−6¼	−2	−6½	−4½	−3	2½
Final domestic demand	½	−1½	−½	−½	−2¾	–	1
Stockbuilding[1]	−3	–	2	½	3	2	1½
Compromise adjustment[1]	−¼	−½	½	−1	1½	¼	–
Total domestic demand	−3	−2	2	−1¼	1½	2½	2½
Exports	½	−4½	¼	−4¼	−2	½	2
Imports	−3¼	−5	6	−4¾	6¼	6	6
Real foreign balance[1]	1	¼	−1¾	¼	−2¼	−1½	−1¼
GDP at market prices	−2	−2	½	−1	−¾	¾	1½
Real personal disposable income	2	−1½	−1	−3½	−2¼	−1½	1¼
Personal savings rate	15¼	14½	13½	14¼	14¾	13½	13½
Private consumption deflator	15½	11	9¼	11	11½	9	8¼
Employees in employment	−2¾	−4½	−1¾	−5	−2½	−1½	−1¼
Unemployment rate[2]	(7¾)	(11¼)	(12¾)	(10¾)	(12)	(12½)	(13)
Current balance of payments ($ US billion, annual rate)	6½	9¾	−¾	14	5½	½	−2¾

1 Change as a per cent of GDP in the previous period.
2 United Kingdom, including school leavers as a per cent of total employees.
Sources: Economic Trends; Press and Information Service Release, June 1981 and OECD estimates.

A small improvement in the earnings/house-price ratio since the spring of 1980, the fall in mortgage rates and a rise in the liquidity position of building societies point to a continuing recovery in private residential investment from the cyclical low around the turn of 1980. In addition, the forecast steep decline in local authority housing investment should also increase the private housing market, as is evident from a sharp rise in private sector housing starts and a sharp fall in public sector housing starts since early 1981. Despite the recovery, however, private residential investment at the end of 1982 is likely to be at a fairly low level by past standards[65]. In total, public and private fixed investment may fall by about 5½ and 8 per cent respectively in the two years to end-1982, thus making it the most contractionary component of domestic demand. Weak profits, positive real interest rates and the relatively high stock/output ratio at the end of 1980 point to further but slower destocking through 1981. This change, and moderate stockbuilding through 1982 should produce an important positive contribution of stockbuilding to GDP growth

65 Private residential investment at the end of 1982 is forecast to be below the level of each individual year between 1964 and 1979 and one-third below the peak in 1972.

Prime Minister

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

3 February 1981

TL 4/2

T. Lankester, Esq.,
Private Secretary,
10, Downing Street

Dear Tim,

OECD ECONOMIC OUTLOOK

Flag A

Thank you for your letter of 30 December. The Chancellor agrees that this was a very unsatisfactory episode, both as regards the failure of the Secretariat to inform the Treasury about the changes in the forecast of the unemployment rate in the UK which they intended to publish; and as regards the breach of the embargo on the OECD Economic Outlook.

The OECD itself has already complained to the Sunday Times about the breaking of the embargo. But the breach of the embargo was if anything less important - and less preventable - than the failure to notify to us changes in forecasts about the UK.

Sir Kenneth Couzens has taken the opportunity of a visit to London by Mrs. Sylvia Ostry (a Canadian), the new head of the relevant part of the OECD, to convey our deep concern about the failure to inform us of changes to the forecast, as well as about the muddle by which following the first breach of the embargo other journalists were released from it by OECD without notice to us. This is the first Economic Outlook for which Mrs. Ostry has been responsible. She is herself upset by what has happened. Treasury officials believe that it was accidental. Mrs. Ostry readily undertook to ensure that in future we shall be notified of any changes to the Secretariat's forecasts relating to the UK. This undertaking is recorded in an exchange of letters with her, and will be reinforced by a letter from our Ambassador to the OECD, Mr. Maddocks, to the Secretary-General, Mr. van Lennep, which will touch also on the embargo.

What the OECD publish is in the end their own responsibility, but if we know clearly in advance what is going to appear, we can seek to influence it, can brief Ministers on it if necessary and can take whatever action seems appropriate with the press.

On the Organisation itself, the Secretariat has a staff of 1700 of whom about a third are professionally qualified. The Economics and Statistics Department employs 150 staff of whom about two thirds are professionally qualified. The annual

why?

/Budget of

Budget of the OECD in 1980 was slightly more than £50 million, of which the UK paid slightly more than £2 million. This was equivalent to about 6 per cent of that part of the Budget met by Member countries' contributions; the proportion borne by the UK has fallen from 16 per cent in 1963, partly because more countries have joined the Organisation, but mainly as a reflection of the decline in relative UK GNP. Our own delegation consists of 13 people, and cost a total of £390,000 in 1979-80. It has declined in numbers over the years, and the number of "professional" staff is now less than half those of the German and Italian Delegations (and lower than those of the low countries, Austria and Greece).

The OECD is the only international organisation which groups all the major industrial economies including both Europe, the US and Japan, and as such it provides a generally useful forum. The size of the OECD staff, however, has grown significantly over the years. Part of this can be explained by the Secretariat's increased work on energy problems and the creation of the International Energy Agency. The Chancellor, however, feels that while the Secretariat's central economic and energy work is valuable and of generally good quality, there is a case for pruning and rationalising work in other areas.

In the annual reviews of OECD's Budget, a number of Whitehall departments have identified scope for savings, and the UK has led the argument for firm control of the Secretariat's expenditure. In both 1979 and 1980 we secured agreement to virtually zero real growth in the Budget. In view of the extra work given to the OECD by Economic Summits, this has forced economies in other areas. The Secretariat is itself introducing a tighter system of manpower budgetting. Inevitably, however, it will remain difficult for an individual member country to maintain effective downward pressure on the expenditure of an international organisation. We have been very disappointed by the lack of support we have received from other major countries - notably Germany and France. Too often we get the blame for being the only "anti" country, without achieving any substantial savings.

The Chancellor feels that we should nevertheless continue to press hard for economies in the less essential parts of the Secretariat's work, and that we should try to ensure that the next Secretary-General has the necessary mangerial skills to keep the Organisation's Budget under firm control. The new US Administration seems likely to prove a more effective ally than its predecessor in the pursuit of these objectives.

I am sending a copy of this letter to George Walden.

Yours

John

A.J. WIGGINS

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Econ Pol

10 DOWNING STREET

From the Private Secretary

30 December 1980

BF 15-1-80

OECD Economic Outlook

The Prime Minister has read your letter of 23 December. She remains very unhappy about the premature disclosure of the OECD report, and she doubts whether their failure to inform the Treasury in advance of their forecast on unemployment was accidental. She has asked that our representatives at the OECD should take up vigorously their failure to give the Treasury advance warning.

The Prime Minister has also asked, in the light of what happened, for a note on the OECD organisation - how many staff, what are their qualifications and who pays, etc. She has also questioned whether we should not reconsider our whole attitude to the organisation.

I am sending a copy of this letter to George Walden (Foreign and Commonwealth Office).

T. P. LANKESTER

A.J. Wiggins, Esq.,
HM Treasury.

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Econ Pol 2

Prime Minister

Duty Clerk 24/12

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

23 December 1980

T.P. Lankester Esq,
No.10 Downing Street

I doubt whether the successive failures to inform the Treasury were accidental. Perhaps we can reconsider our attitude to OECD). MS.

Dear Tim,

OECD ECONOMIC OUTLOOK

The Prime Minister asked about the background to the publication in various newspapers of OECD's forecast that unemployment in the UK will reach 3 million by mid-1982. There are two separate issues - how OECD came to publish the forecast and how it appeared in the press before the embargo date.

The OECD Economic Outlook contains both a general section comparing aspects of the economic situation and prospect in the different member countries, and specific sections on the major economies. In the section on the UK, the "Outlook" stated that unemployment in the UK (including school leavers) would rise to "roughly 12 per cent in mid-1982 or nearly ¾ to 1 million more people than in November 1980". As the figure then was 2.1 million, the press rounded this to 3 million. In the general section on employment prospects in the OECD area, unemployment in the UK is forecast at 12¼ per cent (Table 9), the highest figure of the major 7. In addition there is a forecast for youth unemployment in 1982 of 20 per cent, a figure second only to Italy.

The Sunday Times says the OECD forecast was prepared "after close consultation with the Treasury". It is true that the OECD Secretariat's draft forecasts were discussed by the OECD short term forecasters' and Economic Policy Committee meetings in November, at both of which UK representatives, together with those of other member countries, were present. But because this was before the Industry Act forecast was finished, the UK representatives at the forecasters' meeting did not submit an official UK forecast and confined themselves to commenting on the draft OECD forecast. They were, for example, able to persuade the OECD to reduce their inflation forecast for the UK.

/The Secretariat

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The Secretariat paper discussed at the Economic Policy Committee meeting in November (which as usual covered broadly the same ground as the Economic Outlook), gave a forecast for unemployment of 11 per cent for H1 1982 and a figure of 2½ million for GB wholly unemployed (ie excluding Northern Ireland and school leavers). The general section gave a figure only for 1981 as a whole. The figure quoted was perhaps slightly higher than the 2.3 million for 1981-82 assumed in the Government Actuary's report, but not markedly out of line with it. In early December the OECD Secretariat were sent a copy of the Industry Act forecast, including an estimate of the unemployment in 1981 consistent with it - but this arrived after OECD's deadline and was not able to influence the figures they have published.

In the Economic Outlook, neither part of which is shown in draft to officials of the member countries, the OECD has gone much further than ever before in publishing specific unemployment forecasts. In the July outlook there was no prominent summary table in the general section equivalent to Table 9, merely statements in the country texts relating to mid-1981. On this occasion the time horizon has been extended to 18 months and unemployment forecasts given for the major economies up to mid-1982.

The Outlook makes clear - inside the front cover - that it "is published on the responsibility of the Secretary General. The assessments given of countries' prospects do not necessarily correspond with those of the national authorities concerned". Nevertheless, the Secretariat should be sensitive to the political problems they can cause the members of the organisation. We will be considering whether greater control should be exercised by the members over the drafting of the Outlook, though this would inevitably involve greater responsibility. An alternative might be to try and distance ourselves more from the forecast.

Numbers of OECD staff please - publications - and who pays?

On the question of the early publication of the figures by the Press, the first direct reference was in the Sunday Times two days before Tuesday's embargo. But there was an earlier reference by Frances Cairncross in Saturday's Guardian, where she wrote "A respected international institution will predict a further large decline in output in 1981 and a rise in unemployment to about three million by the middle of 1982". Though this may not break the letter of the embargo it is certainly contrary to its spirit. Following the Sunday Times article the Secretariat lifted the embargo on the section about the UK only, and so informed the UK press. But they failed to let the Treasury Press Office know of this until mid-morning on Monday.

Please take up vigorously with OECD.

/The difficulty

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The difficulty in which the Treasury was placed was increased by the fact that although the Outlook had been in the hands of the UK press for several days, copies only arrived in the Treasury on Monday morning - barely in time for briefing to be prepared had the embargo held. It is plainly very unsatisfactory for the press to be given this material several days in advance of member Governments. We shall now press strongly for copies to arrive earlier, so that we can brief the Press in advance that OECD forecasts should be treated as independent and not as incorporating a Government view.

Yours

John

A.J. WIGGINS

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TELEGRAM NO 99 OF 22 DECEMBER.

OECD REPORT ON BRITISH ECONOMY

1. THE SECRETARY-GENERAL OF OECD TOLD ME HE WAS UPSET BY THE PREMATURE PUBLICATION YESTERDAY BY THE SUNDAY TIMES OF THE GIST OF THE SECTION OF THE OECD ECONOMIC OUTLOOK CONCERNING BRITAIN. ONCE THE REPORT HAD BEEN PUBLICISED THE SECRETARIAT JUDGED IT BEST TO LIFT THE EMBARGO ON THE SECTION OF ECONOMIC OUTLOOK. THE EMBARGO ON THE REST WILL BE LIFTED AS PLANNED TOMORROW.

2. THE SECRETARIAT ARE TRYING TO FIND OUT WHETHER THE SUNDAY TIMES ACTED BY MISTAKE. DEPENDING ON WHAT THEY DISCOVER THEY WILL ADDRESS AN APPROPRIATE MESSAGE TO THE SUNDAY TIMES.

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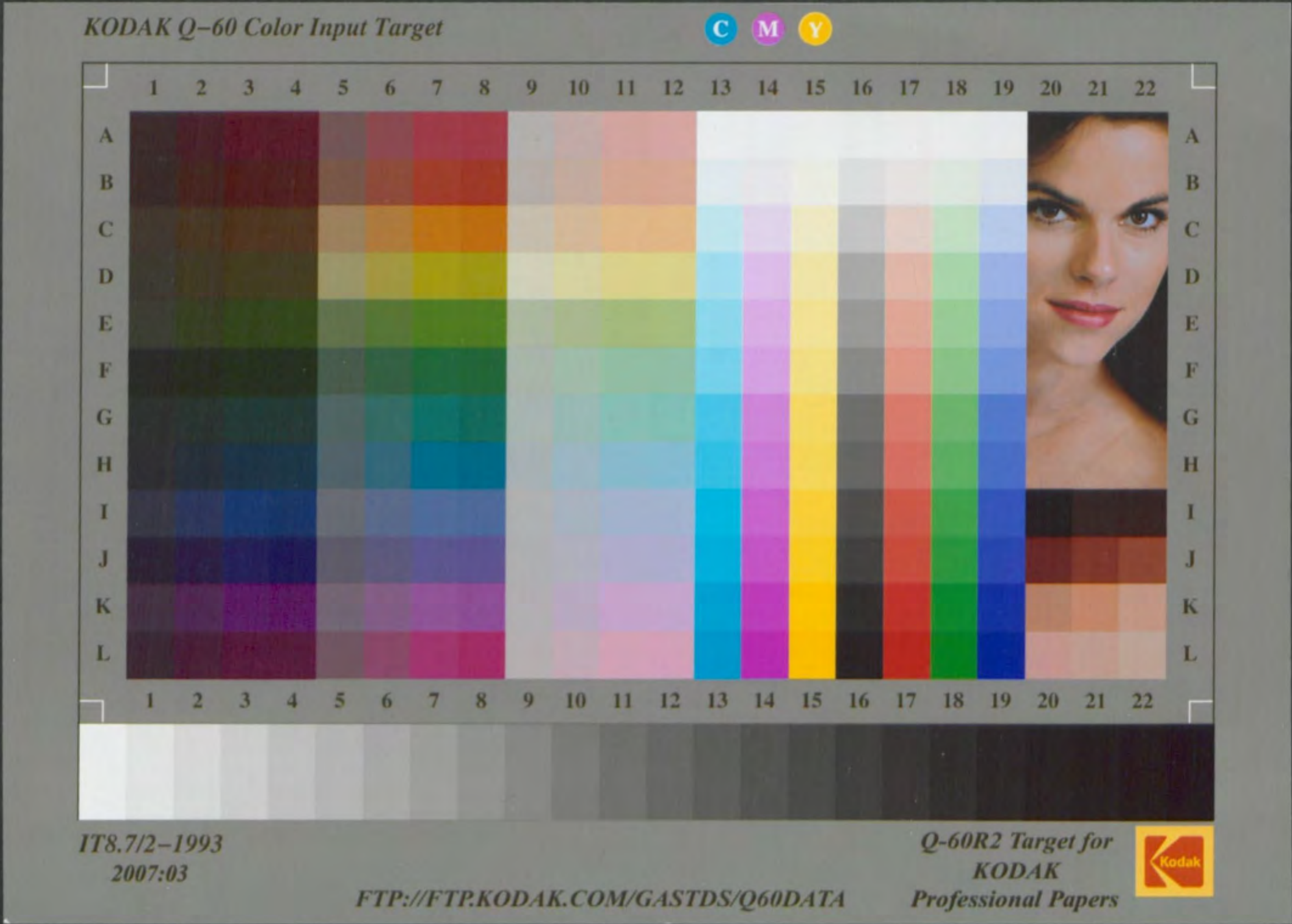
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