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BRIEFING FOR 24 NOVEMBER ANNOUNCEMENTS

I attach briefing on the Chancellor's Statement to be made on Monday 24 November at 3.30 pm. The brief is classified secret except for those passages marked 'Confidential' or 'Not for use'.

(1) N.I. before 1975?
(2) RSG during Peter Shore's time.

A. Bottrill.

A BOTTRILL

EB

23 NOVEMBER 1980

This is an excellent brief

Mr Ehrig : pl cc for
Mr Lipham (at airport)
Mr Griffin
Press Office
Mr Wolfson
Mr Hoskyns
Mr Lankester

+ return to me.

J
24/11

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A1 THE ANNOUNCEMENTS AND GENERAL ECONOMIC STRATEGY

Factual

(i) Announcements fully consistent with Government's medium-term financial strategy of securing sustained reduction in inflation through reduction of monetary growth with complementary fiscal policy.

(ii) No "mini-Budget". Fiscal items cover not this year but 1981-82. Reflect outcomes of usual review exercises ready for announcement at this time of year - broad conclusions of Cabinet discussions of public spending plans and normal autumn review of National Insurance contributions for coming year. New oil tax announced now to allow for consultations with industry and full year's revenue in 1981-82.

(iii) 1981-82 PSBR 1981 Budget time for firm view. As MTFS provides must take account inter alia of impact of recession. There is no PSBR'target'.

(iv) Monetary target decision to reaffirm present £M3 7-11 per cent (at annual rate) target range to April 1981, follows 1980 Budget commitment to review target this autumn. Aim in 1981 Budget will be to set a new target together with any further measures needed to maintain thrust of MTFS.

(v) Monetary control . Announced conclusions of consultations, based on March Green Paper, about methods of monetary control - form of Bank's controls over money markets and banks. Some significant technical changes to be made which improve control over longer-term, but overriding requirement will remain fiscal policy which complements monetary restraint.

(vi) Public Expenditure. Recession has sharply affected expenditure 1980-81 expenditure expected to be some 1½ per cent higher than at time of Cmnd 7841. Recent decisions minimise departure from earlier plans. Aim for 1981-82 is to keep planned volume of expenditure about 1 per cent below expected 1980-81 outturn. Firm restraint of 1981-82 cash spending essential to keeping cost of programmes under control: thus, for example, 6 per cent factor for pay and 11 per cent for other items in Rate Support Grant cash limit. Total spending and borrowing must be consistent with medium term strategy.

/ A1 continued

THE ANNOUNCEMENTS AND GENERAL ECONOMIC STRATEGY

Positive

(i) Government determined to take sensible and timely action . Increase in employee NIC and oil tax proposal together raise extra revenue of some £2 billion in 1981-82. Essential steps in restraining PSBR for next year so that monetary restraint can be secured without excessive interest rates.

(ii) Inflation: New Industry Act forecast confirms that inflation will continue to fall - essential prerequisite for recovery in output and sustainable economic growth. Annual rate of inflation recorded by 4th quarter of 1981 is expected to be about 11 per cent compared with 15½ per cent forecast to the 4th quarter of this year.

Defensive

(i) Output in course of 1981 expected to remain fairly flat - as in many other countries. Unemployment will inevitably rise further. Reflects worldwide developments, high exchange rate and past failure to restrain pay settlements. Timing of recovery in output and employment depends very much on rate at which UK costs - particularly pay costs - come into line with overseas competitors.

(ii) Restraint of PSBR remains important. Recession can mean that higher level of PSBR than otherwise is tolerable. But remains essential to avoid excessive borrowing that would put unacceptable pressure on interest rates. Hence measures at this stage - oil tax and NIC increase - to help restrain 1981-82 PSBR.

PSBR

(iii) 1980-81 PSBR now forecast at £11½ billion, reflects impact of recession eg on public spending as a result of higher unemployment. On cash-limited programmes and nationalised industry EFLs government has acted to contain pressures as far as possible. Expenditure not out of control.

(iv) Any excess monetary growth in current target period expected to be less than recent statistics might imply: public sector expected to move into surplus in New Year and signs that bank lending may be starting to slow down. Initiatives (eg National Savings) to reduce dependence on gilts and encourage revival of long-term debenture market. Effect on future inflation hard to predict - no mechanistic relationship between money and inflation, wrong to focus on monetary growth over an arbitrary short period when overriding need is to restrain monetary expansion over medium-term.

CONTACT POINT: M FOLGER 233-8737

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A2. CHECK LIST OF MEASURES (Briefs in brackets)

Monetary policy

(i) 7-11 per cent target growth rate retained for period Feb. 1980 to April 1981 (D1)

(ii) Reserve asset ratio for banks to be phased out after consultation on new arrangement for prudential liquidity. (D2)

(iii) Bank of England to change money market operations and last resort lending to allow market greater role in determining short-term interest rates (D2).

(iv) Eligibility to buy index-linked National Savings certificates to be extended in future. (D3)

Public expenditure(details in H1)

Changes to expenditure programmes for 1981-82 due to policy decisions since March 1980 public expenditure White Paper Cmnd 7481):

	1981-82 £m1980 survey prices
Nationalised industries increase in EFLs (other than British Steel)	+ 620
Other policy increases (including special employment measures, industrial support, withdrawal of proposed new health charges and others)	+ 510
EC refunds (agreed 30 May 1980)	- 650
Reduction in programmes (including local authorities current spending, defence, ECGD, social security, DOE and others)	-1070

Revenue

(i) Employees Class 1 national insurance contributions increased from 6¾ per cent point to 7¾ per cent on 1 April 1981. Payable on earnings of £27-£200 pw. (raised from £23-£165 pw). Estimated to raise around £1 billion in 1981-82. Employers' contribution unchanged. (See G1)

/A2 continued

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(ii) New petroleum production tax to take effect from 1 January 1981. PRT reliefs to be examined. Expected total yield around £1bn in 1981-82 (See F1).

Pensions

(i) Uprating of retirement pensions and other social security benefits to be adjusted in 1981. Uprating to allow for over provision this year estimated at 1 per cent. (See H7).

CONTACT POINT: C H K WILLIAMS 233-7064

B1. UK ECONOMY - PRESENT SITUATION

(i) Output and demand: Output measure of GDP in Q3 1980 provisionally estimated almost 4½ per cent below average 1979. Decline in demand uneven. General Government consumption has held up, and so have exports until recently. Consumers' expenditure in Q3 estimated to be less than ½ per cent below average 1979. Fixed investment in Q2 was 1 per cent below average 1979, but capital spending by manufacturing, distributive and service industries fell further in Q3. Major reduction in final demand reflects fall in stocks. Industrial output in Q3 9 per cent below average 1979 and manufacturing 11½ per cent down.

(ii) Employment and Unemployment: Employment fell by 400,000 in year to June - just under 2 per cent. Fall heavily concentrated in manufacturing where employment fell by further 150,000 in July and August taken together. UK unemployment (excluding school leavers) was 1.9 million (7.8 per cent) at the October count, a rise of almost 600,000 since December.

(iii) Company finances: In H1 1980 gross trading profits net of stock appreciation and interest payments fell slightly for industrial and commercial companies excluding North Sea activities. Net borrowing rose substantially to £4½bn mainly financed by bank borrowing.

(iv) Earnings and Prices: Over last pay round earnings grew by 21½ per cent, well above the rise in UK prices and increase in earnings of major competitors. Comparatively few settlements so far in current round, but indications of a substantial decline with some settlements in manufacturing in single figures. Prices of materials and fuels purchased by manufacturers has been virtually flat in six months to October reflecting the appreciation of sterling and weak commodity prices. Wholesale output prices rising at an annual rate of 8½ per cent in six months to October. October RPI 15½ per above a year ago.

Balance of payments (See C1)
Exchange rate and Competitiveness (See C2)
Money supply (See D1)
PSBR (See E1)

/B1 continued

Positive

(i) Substantial progress on reducing inflation. Better than forecast and lower wholesale prices still to work through fully.

(ii) Encouraging signs of realism in wage negotiations. Substantial drop from level of last round. Manufacturing settlements in single figures. Industrial stoppages lowest for 30 years.

(iii) Balance of payments strong in contrast to other countries.

Defensive

(i) Last year's rise in consumer expenditure unsustainable as it was not matched by higher output.

(ii) Investment and stocks decline reflect usual cyclical downturn, but also squeeze on profits.

(iii) Recent decline of exports reflects at least partly lost competitiveness and emphasises need for wage moderation.

(iv) Inflation trends better than that inherited. In last six months of previous administration annual rate was 14 per cent and rising. Six monthly rate now lower and trend falling.

(v) Latest 26 per cent year-on-year earnings rise for September distorted by back pay (now) and engineers' dispute (a year ago). Current settlements much lower than in last wage round.

(vi) Unemployment similar in United States, Canada and France. UK however suffering from self-inflicted damage of past wage excesses over productivity and failure to adjust.

Contact point: C Williams 233-7064

B2 Industry Act Forecasts

Factual

1. Industry Act Forecast published on 24 November by Press Notice meets the requirement of 1975 Industry Act for Government to publish two forecasts a year.

2. Coverage of forecast much the same as usual: text includes references to manufacturing and North Sea output and to world trade.

3. Main points of forecast (see Table 1):-

(i) Inflation continuing to fall: perhaps to 11 per cent by end 1981.

(ii) Output fall in 1980 of 3 per cent, in 1981 of 1½ per cent, but with no further fall from current levels.

(iii) Current account of balance of payments forecast to remain in substantial surplus.

(iv) PSBR in 1980-81 now estimated at £11½ billion, 5% of GDP; some fall in percentage of GDP expected in 1981-82.

(v) All forecasts, especially in current circumstances, subject to large margins of error: figures in table 1 of error margins are average errors derived from past forecasts, and not outer limits.

Positive

1. Major reduction in inflation already achieved this year; further substantial fall envisaged next year. Single figure inflation next year a real possibility.

2. Worst of output fall may now be over: forecast shows no further decline either in total output or in manufacturing output in the course of 1981.

3. Average standard of living not likely to decline much, despite much lower rate of pay settlements.

4. Prospect of some fall in PSBR (as percentage of GDP) in 1981-82 consistent with downward trend envisaged by MTFS.

Defensive

1. UK economy facing difficult period of adjustment because of: adaptation to falling inflation; high exchange rate; world recession.

2. Fall in output, especially in manufacturing, greater than expected at this time last year or at Budget time; nevertheless, government forecasts not very far out.

3. Fall in volume of exports in 1981 foreshadowed by: past losses in competitiveness; export orders; tailing off in last few months.

4. PSBR this year higher because of extra government spending, partly because of recession, and because local authorities and public corporations have borrowed more than expected.

5. Can't be more precise about PSBR in 1981-82 because of the difficulties of forecasting the balance between very large (£125 billion or more) revenues and expenditure, and because many fiscal policy decisions on the year naturally await Budget.

6. Unemployment is bound to go on rising for some time, but rate of increase should slow down. [No figures given in Industry Act forecast: the figure of 2.3 million wholly unemployed. GB, appearing in the Government Actuary's Report [to be published on Monday 24 November] is an assumption - not a forecast - given to the Government Actuary for the purpose of his calculations on the National Insurance Fund.]

7. No figure for earnings growth given in Industry Act forecast, but reference to "less than half the rate in previous pay round". Government Actuary's report uses figure - again as assumption, not forecast - of 10½% earnings growth for financial year 1981-82 on 1980-81.

8. Government is merely following all past precedent in not giving forecasts of unemployment, or precise forecasts for earnings.

Contact Point: Mr H P Evans 233 4297

TABLE 1: ECONOMIC PROSPECTS TO END 1981

	Percentage changes 1979 to 1980	Percentage changes 1980 to 1981	Margins of error// for 1981 forecast per cent
A. OUTPUT AND EXPENDITURE AT CONSTANT 1975 PRICES			
Gross domestic product (at factor cost)	- 3	- 1½	1½
Consumers' expenditure	0	- ½	1½
General Government expenditure on consumption and investment	- 1	- 2	1½ /
Other fixed investment	½	- 4	4 *
Exports of goods and services	1	- 3	3½
Change in stockbuilding as a percentage of GDP	- 4	1	1
Imports of goods and services	- 3	0	2½
B. BALANCE OF PAYMENTS ON CURRENT ACCOUNT	1980	1981	
	£ billion		£ billion
	2	2	2
C. RETAIL PRICE INDEX	Percentage changes		Per cent
	4th Quarter 1979 to 4th Quarter 1980	4th Quarter 1980 to 4th Quarter 1981	
	15½	11	3

// The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on government forecasts, notably in November 1978 (see Economic Progress Report Supplement or Economic Trends No. 301, November 1978). The calculations for the constant price variables are now derived from internal Treasury forecasts made during the period June 1965 to October 1978. For the current balance and the retail price index forecasts made between June 1970 and October 1978 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

/ This margin applies to general government consumption only.

* This margin applies to private sector investment only.

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B3 OUTSIDE FORECASTS

(New NIESR forecast is expected in the week beginning 24 November and a new CBI forecast in the first week of December.)

FACTUAL (See also B2 - Industry Act forecast)

(i) GDP forecasts for 1980 and 1981 progressively more pessimistic. Fall of 2½ to 3½ per cent in 1980 is broad consensus (although CEPG in April forecast a fall of 6 per cent). For 1981 there is less agreement. Most forecasts predict falls of ½ to 2 per cent, although ITEM expect 4 per cent drop.

(ii) Inflation forecasts have become progressively more optimistic. Only LBS, however, expect single figure inflation (in consumer prices) by end 1981. Most others forecast 11½-12½ per cent. ITEM, however, predicts increase in the RPI of over 14 per cent in 1981 as a whole.

(iii) Unemployment forecasts are increasingly pessimistic. Almost all forecasters agree on 1.9 million adult unemployment (seasonally adjusted) for 1980 Q4. For 1981 Q4 there is a reasonably narrow range of 2.2 million (LBS) to 2.6 million (CEPG, Charterhouse).

(iv) PSBR Most recent forecasts range from £10 billion (LBS) to £13½ billion (ITEM). For 1981-82, forecasts range between £9½ billion (LBS) to £14 billion (ITEM).

(v) Sterling M3 For 1980-81 growth forecasts mainly fall in the range of 13½ per cent (St James Group) to about 16 per cent (Phillips and Drew). In 1981-82 only LBS expect a growth within the MTFS target of 6-10 per cent. Only Phillips and Drew expect a significant fall in MLR this financial year, although most predict a fall to 11-12 per cent for 1981-82 as a whole.

(vi) Current balance of payments forecasts have become more optimistic, but 1981 forecasts range from a £1½ billion deficit (LBS) to £1¼ billion surplus (Phillips and Drew.)

(vii) Medium-term forecasts There is disagreement on timing of GDP trough and extent of recovery. LBS and Phillips and Drew expect activity to recover from low point in H1 1981.

/B3continued

For 1982 and beyond LBS forecast a strong recovery with GDP growth of about 2 per cent per annum. Other forecasters are less optimistic. All forecasters expect further reductions in inflation rate. There is general pessimism over unemployment. Camb. Econ. and CEPG forecast over 3 million by 1983 and further increases by 1985. LBS see 2¼ million by 1982 but no fall over next four years.

(viii) Policy comments Only LBS has consistently advocated MTFS. Increased PSBR during recession is seen as consistent with stated £M3 targets. Other forecasters range from sceptical (Camb. Econ. and Phillips and Drew) to opposed (NIESR and CEPG.) NIESR favour more direct action on wage bargaining, whilst CEPG champion import controls. Both recommend expansionary fiscal policies.

Positive

(i) All forecasters have become more optimistic on inflation outlook.

(ii) All forecasters now forecast a more favourable current account balance for 1980 and 1981.

(iii) At least some forecasters expect activity to recover in the course of 1981.

Defensive

(i) All forecasts are subject to margins of error. Forecasters have for example, markedly underestimated the fall in inflation and the continuing favourable balance of payments, and there is a wide-range of projections for the PSBR.

(ii) Unemployment forecasts are particularly subject to wide margins of error and uncertainty; and have often been wrong in the past.

(iii) Groups advocating reflation overlook longer-term inflationary consequences of such policies.

(iv) Import controls would risk breaking UK's international agreements, risk retaliation and not guarantee extra output/employment.

CONTACT POINT: A SMITH (EB) 233-4524

C1. BALANCE OF PAYMENTS CURRENT AND CAPITAL ACCOUNTS

Factual

(i) Current account surplus £1.2 billion in first 10 months of 1980, made up of £200 million visible trade surplus and estimated £1 billion invisible surplus.

(ii) Capital account shows inflow of £1.4 billion in first half of 1980. Private non-residents' sterling deposits increased £1¾ billion in first half 1980.

Positive

(i) Current account surplus likely to persist though not on scale of last few months. (see B2 Industry Act Forecast).

(ii) Recent large surplus reflects better than expected performance on invisibles and continuing movement in our favour of terms of trade (excluding oil up 7 per cent in the first three quarters of this year). But main reason is a sharp fall in imports which were £1.3 billion lower in third quarter than in the first largely reflecting destocking.

(iii) Oil account now likely to be in regular surplus.

(iv) Capital outflows following abolition of exchange controls still building up and should offset some upward pressure on exchange rate.

Defensive

(i) It is true that our volume share has probably declined during 1980. This emphasises the need to regain the competitiveness we have lost.

(ii) Good export performance depends on controlling UK costs not exchange rate depreciation.

(iii) No reason to believe that bulk of non-resident sterling holdings are particularly volatile.

CONTACT POINT: MR ALLAN 233-3496

C. EXCHANGE RATE AND COMPETITIVENESS

Factual

(i) Sterling has risen around 7½% against dollar and 6½% in effective terms since the Budget. On 21 November it stood at $ 2.3640 (77.4 effective).

(ii) Exchange rate determined primarily by market forces. Intervention by authorities limited to smoothing excessive fluctuations.

(iii) Sterling's underlying strength derives from possession of North Sea oil and market confidence in Government's commitment to defeat inflation.

(iv) Latest estimates of competitiveness:

		Relative normal unit labour costs	Relative export prices	1975 = 100
1978		96.5	108.4	
1979		111.7	115.8	
1980	Q1	126.1	123.3	
	2	134.0	127.2	
	* 3	140	130	*Unpublished Treasury projections. For use only if pressed
	* 4	145	130	

[In terms of relative normal unit labour costs, our competitiveness is about 40%-/50% worse than in 1978]

Positive

Appreciation of sterling has helped to contain inflation.

Defensive

(i) Current level of sterling not sought as deliberate policy.

(ii) Impossible to control the exchange rate while giving priority to meeting the monetary target.

(iii) Greater part of competitiveness loss stems from UK's relatively high wage increases than from rise in exchange rate. Vital that all take account of competitiveness pressures in negotiating wage settlements.

(iv) Sustained intervention could not guarantee lower rate but would risk adding to money supply with inflationary consequences.

(v) No reliable relationship between interest rate and exchange rate movements. Interest rates must be determined by domestic considerations.

(vi) Inflow controls unlikely to be effective for more than short period, given sophistication of London's financial markets.

(vii) Some underlying factors may exert downward pressure on rate in future: private sector outflows are growing could accelerate, as could overseas borrowing in sterling market.

(viii) The Industry Act forecast projects little movement in exchange rate from mid-November level. This is a conventional assumption - not a prediction of the actual movement in the rate.

CONTACT POINT: Miss O'Mara 233-4621
Mr Allan 233-3496

D1. MONETARY POLICY: ROLL FORWARD AND INTEREST RATES

Factual

(i) The Chancellor does not propose to roll forward the present monetary target range of 7-11 per cent annual rate for period February 1980 to April 1981. He will announce a new target in the Budget together with whatever further measures are necessary to ensure that the thrust of the medium term financial strategy is maintained.

(ii) Maximum allowable growth over 14 months at top of range was 12.9 per cent. Actual growth from February to October has been about 15½ per cent or about 13 per cent after adjustment for corset distortions. Expressed in annual rates, recorded £M3 has been growing at 23.8 per cent. Underlying rate, after allowances for unwinding of corset distortions, around 20 per cent.

Positive

(i) Accept almost certain overshoot of current target, but recent statistics for £M3 growth seriously distorted by reintermediation after ending of corset controls in June. Full extent of distortions not yet clear.

(ii) Rate of monetary growth expected to slow in rest of target period, particularly in New Year when the public sector moves into surplus. Also substantial sales of National Savings expected and signs that growth in bank lending starting to decline.

(iii) National Savings initiatives (see D3) will reduce reliance on the gilt-edged market and, by making it possible to achieve monetary objectives at lower rates of interest, encourage revival of corporate debenture market.

(iv) In view of above factors, overshoot compared with target will not be large and certainly very much less than figures so far might suggest. Government has decided not to roll forward the monetary target now but to wait until the Budget.

D1.

(v) Fiscal measures in Budget will be designed to validate the target for 1981-82, maintaining thrust of medium-term financial strategy.

Defensive

(i) No suspension of monetary target. There will be some overshooting, but £M3 will slow appreciably in rest of target period. We shall not be far above top of range by April, certainly nothing like as far as the growth so far might be thought to imply.

(ii) MTFS not abandoned: The Government remains firmly committed to a progressive reduction in money supply growth. A new target which maintains the thrust of the strategy, will be announced at the time of the Budget. At the same time, whatever fiscal decisions necessary to validate the strategy will be announced. Some decisions, with a long lead time, announced today.

(iii) Not true that an interest rate target has replaced money supply target. Commitment remains to reduction in rate of growth of money supply. Interest rates will need to be adjusted from time-to-time to that end.

(iv) Clawback of excess growth in new target? Obviously, no decisions have been reached on form of target or the range for 1981-82 and later years. Need to reassess carefully at Budget time the underlying excess this year. Will decide target then in the light of this reassessment, the growth of other aggregates and developments in the economy generally.

(v) Will recent excess growth produce inflationary burst in 12-18 months? No. Important not to draw conclusions based on short period. The latest Greenwell's bulletin, not always supportive of Government policy, points out the error of this approach. We expect second half-year monetary growth to be much lower. Inflation is coming down sharply and the forecast for the next 12 months is 11 per cent.

D1.

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Essential that monetary growth should decelerate sharply to avoid re-acceleration of inflation as economy returns to fuller capacity use.

Contact point: H DAVIES 233-4533

D2 MONETARY CONTROL TECHNIQUES: MBC

FACTUAL

1. As foreshadowed in Green Paper, Reserve Assets Ratio will be abolished as soon as consultations with banking system regarding alternative prudential arrangements can be completed.

2. No decision for or against Monetary Base Control now, but:

(i) Bank and Treasury considering future of $1\frac{1}{2}$ per cent cash ratio.

(ii) Statistics to be collected for "retail" money (akin to old M2 series).

3. Changes will be introduced in the Bank of England's methods of intervention in money markets:-

(i) Less emphasis on discount window (lender of last resort) lending, and more on open market operations.

(ii) Aim of open market operations will be to keep very short term interest rates within band determined by the authorities. Band will not be announced.

(iii) At appropriate stage, Bank might cease to announce MLR, and would normally charge a rate above market rates on its discount window lending.

4. Bank has issued a briefing note for the press on these changes.

Line to Take

1. Government is attracted by the idea of moving towards MBC, but no firm decision can be made on basis of present knowledge. Evolution of monetary control system must be gradual, learning from experience.

2. Monetary base control would not provide short-term control of £M3 or other wide monetary aggregates. Entails setting targets either for a relatively narrow aggregate (eg. "retail" deposits) or for base itself. Market would determine short-term interest rates consistent with that target. Already take some account of narrow aggregates in setting interest rates under present system.

3. To judge the potential of MBC, more information needed:-

(a) For non-mandatory MBC, need to know extent of banks' demand for balances with the Bank of England, and its relation to money supply and price level. Cannot learn this whilst $1\frac{1}{2}$ per cent requirement in force.

(b) For mandatory MBC, need to know characteristics of "retail" deposits, since a reserve requirement related to wholesale deposits would produce distortions similar to those observed under SSD scheme.

4. Other steps announced today are desirable in own right and appropriate to evolution towards MBC:

(a) More flexible approach to money market operations will give market more of a role in determining structure of short-term interest rates. Banks will no longer be certain that they have access to unlimited supply of cash at known price; will, therefore, have more incentive to keep their lending rates in line with market.

(b) Abolition of Reserve Assets Ratio will remove a factor distorting relative yields between Treasury bills and other short-term financial instruments. The Bank will be examining potential for developing wider market in short-term central government debt. This might help monetary control by providing greater flexibility to funding programme.

5. The Bank will discuss operational details of changes with institutions affected as soon as practicable. New arrangements should be in place in Spring.

DEFENSIVE

1. Nothing Here to Improve Control of £M3

Control of £M3 a medium-term objective to be achieved by the general thrust of government policies including fiscal policy and debt sales. Commitment to MTFS stands.

2. Will Government be Abandoning £M3 in Favour of Narrower Aggregate?

No, under any system we shall need to control wider aggregates in the medium term.

3. How Will More Flexible Interest Rates Help Monetary Control?

May change way banks charge for advances and accelerate changes in overdraft system - bank lending will then become more responsive to market interest rates. Will reduce drama associated with MLR changes. May pave way for a later decision to set objectives for monetary base instead of interest rates.

4. How do the New Arrangements Allow a Greater Role for the Market in Determining Short Term Interest Rates?

The Bank will only act to limit movements in very short term interest rates (overnight, 7 day rates). Band within which it will seek to keep these rates will not be announced. Authorities' views will therefore be less overt, leaving market more of a role in determining the structure of other interest rates.

5. Will the Band Be Set With Reference to Movements In the Monetary Base?

Authorities will take account of same factors as now determine choice of MLR. When more information is available about the behaviour of the base, it might become appropriate to take this into account too.

6. How Much Volatility in Short-Term Interest Rates will the Bank Tolerate?

No precise answer possible. But intend to proceed gradually. Wild gyrations in short-term rates can be ruled out.

7. Will MLR Disappear?

At some stage the Bank may cease to announce a MLR. Not possible to be more precise; changes to the status of MLR could have legal implications which must be examined further.

8. Is This a Return to the Formula System for MLR?

No. The relationship between MLR (or its successor) and comparable market rates will be at discretion of authorities. No set formula.

9. Money Market Assistance: Does It Go On?

Measures necessary to prevent RAR from undesirably affecting interest rate levels and perhaps artificially inflating money supply ("round tripping"). Green Paper explained why it is neither necessary or suitable for controlling money supply. Solution depends on replacing RAR by alternative prudential arrangements. In meantime, Bank is considering transitional measures to relieve reserve asset pressure which would reduce need to give substantial amounts of money market assistance (eg. by modifying definition of reserve assets).

10. Will the Discount Houses Disappear?

New methods of operating in money markets assume a continuation of the discount market in its present form. Discount window facilities will continue to be confined to members of London Discount Market Association.

11. <u>Why not abolish RAR now if counter productive for monetary control purposes?</u>

Reserve asset ratio has a prudential function in determining bank's holdings of liquidity. Premature to abolish it until alternative arrangements have been made. Further consultations with banks required.

Contact Point: Mrs Lomax 233 5570

D3 NATIONAL SAVINGS

Chancellor announced eligibility to purchase Index-Linked National Savings certificates will be widened in future to maintain momentum of National Savings and attract at least £3 billion next year. (At present those aged 60 and over may buy up to £3,000 of Second Index-Linked Issue, which went on sale at Post Offices and Trustee Savings Banks on 17 November.)

Positive Points

(i) Government planning to secure about £1.5 billion of additional funding from new issue during current financial year as major component of overall contribution from National Savings of about £2 billion.

(ii) Extensive campaign of TV and press advertising.

(iii)Making current issue available to men aged 60 and over ends previous discrimination in favour of women.

(iv) Substantial contribution from the personal sector will reduce need for gilt sales and should help revive long-term debenture market.

Defensive Points

(i) Effect on building societies: Some of inflows to National Savings will be at expense of building societies, but their loss expected to be less than half gain to National Savings. Inflows to societies have recovered strongly in recent months, while demand for housing finance appears to have slackened.

(ii) Inflows in excess of £3 billion into National Savings will indeed establish new records for this source of funding but are consistent with what has been achieved before in terms of a proportion of personal sector's savings.

Contact Point: Mr G Ward 233 5466

D1. THE STATEMENT AND THE MTFS

Factual

(i) The MTFS set out the government's commitment to reduce the rate of inflation and thereby secure the conditions for sustainable growth.

(ii) The principal means to ensure the fall in the rate of inflation was a commitment to declining monetary growth (to a target range of 4-8 per cent during 1983-84). There were no precise targets for the intervening years 1981-82 and 1982-83.

(iii) Control of the money supply is not to be achieved by persistently high nominal interest rates, but by control of public sector borrowing.

(iv) There are no targets for the PSBR. The projections of the PSBR in the MTFS were purely illustrative.

> "Fiscal policy will be operated so that the PSBR for any particular year will be consistent with declining monetary growth in the particular circumstances of the time." (MTFS, paragraph 12)

Positive

(i) The extra revenues, the cuts in public expenditure volumes (to offset increases in other categories), and the firm control on public sector pay will contribute towards control of the PSBR in 1981-82.

Defensive

(i) Does the failure to control the money supply and the PSBR in 1980-81 mean that the financial strategy has failed? No. The government is just as firmly committed to declining monetary growth in future years as at the time of the MTFS.

/continued

(ii) Will the likely failure to achieve the 1980-81 target result in changes to targets for later years? The government intends monetary deceleration to be broadly along the lines set out in the MTFS. The only target is for monetary growth of 4-8 per cent in 1983-84. The target rates of growth in the intervening years will be set at the time.

(iii) PSBR in 1981-82 to be too high to achieve monetary growth consistent with MTFS? The government will take whatever measures are necessary to achieve a satisfactory PSBR in the particular circumstances at the time of the 1981 budget. The measures set out in the Chancellor's statement are not the 1981 budget.

(iv) Is allowing the PSBR to rise in a recession contrary to the MTFS? No. In a recession a higher PSBR than usual should be consistent with a particular growth of the money supply (at acceptable interest rates). The judgement on what PSBR is right for 1981-82 will be taken at the time of the budget.

Contact point: G R LEWIS 233-3093

E1. PUBLIC SECTOR BORROWING REQUIREMENT

Factual

(i) PSBR out-turn in first half of financial year 1980-81 was £8 billion seasonally adjusted. High out-turn reflects partly uneven timing of receipts and expenditures, over-spending on defence and lower than expected tax revenues. Borrowing should be lower in rest of financial year - reflecting rising North Sea tax revenues , receipts from asset sales and refund from EC Budget.

(ii) PSBR for 1980-81 as a whole now expected to be around £11½ billion (5 per cent of GDP at market prices) compared with £8½ billion FSBR forecast. Increase reflects at least partly unanticipated effects of recession on public spending and on trade of nationalised industries. (See B2 Industry Act forecast)

(iii) PSBR prospect for 1981-82 is for some fall as a percentage of GDP on the basis of the fiscal and monetary policy assumptions used in the Industry Act forecast i.e. taking account of the fiscal decisions announced by the Chancellor.

Positive

(i) Government remains committed to MTFS, PSBR consistent with declining monetary growth.

(ii) Final decision about PSBR ~~for~~ to aim in 1981-82 must await the Budget, but tax and spending measures announced today demonstrate Government's determination to check public borrowing.

(iii) PSBR for 1981-82 will be consistent with Government's monetary objectives.

(iv) Interest rates (See D1).

Defensive

(i) Government is not abandoning MTFS. It was always made clear that fiscal policy would be operated so that PSBR for any particular year was compatible with the Government's monetary objectives (FSBR - page 18). There is no PSBR target.

(ii) Realistic to allow for some increase in public spending and borrowing as a result of recession. But totals must be consistent with financial strategy and continued reduction in inflation if sustainable growth is to be renewed.

(iii) PSBR forecasts subject to wide error margins - emphasised at time of Budget forecast (± £3 billion). Uncertainties for 1981-82 must similarly be stressed.

CONTACT POINT: A R H BOTTRILL 233-5886

F1 CHANGES TO NORTH SEA FISCAL REGIME

Factual

(i) New tax on UK oil revenues will take effect from 1 January 1981. Additional to existing petroleum revenue tax (PRT). (Timing of payments still to be decided).

(ii) It will be charged, on a field basis, on gross revenues less a deductible allowance - as in (v) below. (PRT, by contrast, is charged on revenue less deductions for actual expenditure and a deductible oil allowance.)

(iii)It will be deductible for PRT and Corporation Tax purposes.

(iv) It is intended to increase net yield from oil taxation by about £1 bn in 1981-82 and by significant amounts (though less than £1 billion) in later years. (For expected North Sea revenues see F2)

(v) For illustrative purposes, increased yield would be achieved by setting rate at 20% and deductible allowance at value of 1 million tonnes of oil for each field for each year.

(vi) Detailed proposals will be introduced in 1981 Finance Bill after discussions with the industry.

(vii)Ministers will also examine present scheme of PRT reliefs (uplift, safeguard, oil allowance) in light of changed conditions (oil price increases, cost increases, technical experience, production and tax changes) since reliefs introduced. Again, changes will take effect from 1.1.81 and be introduced in 1981 Finance Bill after discussions with the industry.

(viii)No decision taken yet about abolition or retention of the PRT advance payment system.

(ix) Outline of proposals set out in Inland Revenue Press Release.

Positive

(i) Need to strike fair balance between nation and companies in sharing fruits of North Sea.

(ii) Oil companies have benefited from very substantial increase in oil prices in last two years (and despite two tax changes). Since fourth quarter 1978, world price of oil (in $) has risen 150 per cent. Rise in £ exchange rate means rise in £ price is less - 110 per cent. This is still considerably greater than rise in general prices level.

(iii)The new tax is justified on its own merits in the light of the profitability of the North Sea. The increase in yield will obviously help with the PSBR (and therefore interest rates).

(iv) Announcement in advance allows time for companies to have meaningful discussions with IR on details.

/continued

Defensive

(i) Why a new tax? PRT currently narrowly-based; so being presently paid by relatively few companies in relatively few fields. Could not yield same extra revenues without undue pressure on those companies and those fields. New tax will spread effect more fairly than charges in PRT raising equal amount of revenue.

(ii) Penalising profitable companies? Charges should not deprive companies of a fair return on North Sea projects and exploration.

(iii) Effect on company profitability? Will depend on type of fields owned by Company. In general likely rates of return only slightly reduced. Proposed deductible allowance will help to shelter smaller fields.

(iv) Effect on exploration and development? North Sea activity currently buoyant - shortage of some equipment. Very conscious of need to preserve attractiveness of North Sea as an area for new investment.

(v) Effect on 7th Round Licensing? No reason to believe proposals will discourage companies from taking up and exploiting any acreage they are offered. The proposals have been developed in full consultation with Departement of Energy.

(vi) Impact on marginal fields? Proposed allowance intended particularly to help shield marginal fields.

(vii)Stability assurances? Fully appreciate importance of stability for industries with long lead-times for investment. But never ruled out change in any circumstances. Oil world and UK economy have changed greatly since PRT introduced; changes have become too great for PRT to cope with.

(viii) Changes to PRT reliefs. As PRT rate has increased from its original level, some of PRT reliefs may have had unforeseen effect. Full proposals in 1981 Finance Bill. But IR will discuss possible changes with industry.

(ix) World oil prices now stable? True they have been more or less stable since mid-1980. But have risen over last two years. Government now had further time to consider implications of the second oil price explosion for the N. Sea fiscal regime.

Contact point: Mr Haigh IRD 438 6670

F2 FORECASTS OF GOVERNMENT REVENUES FROM OIL AND GAS PRODUCTION IN THE NORTH SEA

Factual

(i) Industry Act forecast includes forecasts for total North Sea revenues. These are:-

£billion at 1980-81 prices [1]	
1980-81	4
1981-82	4½ - 5

Figure for 1981-82 includes the additional revenue to be raised by means of supplementary tax announced in the Chancellor's Statement. (See F1).

(ii) Figures cover royalties, PRT, corporation tax, and (for 1981-82)/extra revenue from the supplementary tax. They include receipts from all companies operating in North Sea including payments by BGC and BNOC. They exclude operating surpluses of BGC and BNOC.

(iii) In spite of the additional revenue in 1981-82 from the announced tax changes c. £1billion at current prices - the total government take at constant 1980-81 prices will be only £0-½billion higher than forecast at the time of the Budget.

(iv) Downward revision to the forecast of government take (if the effects of the supplementary tax are ignored) is partly the result of lower production and upward revision to forecasts of investment. (The oil production estimate for 1980 of 81 million tonnes given in the new Industry Act forecast is below the centre of the 1980 Brown Book range.) /IF PRESSED: the same may be true next year./

(v) After 1980 Budget, Government published forecasts of its North Sea revenues for each financial year until 1983-84 (ie. the period of the MTFS). There are no revised forecasts for 1982-83 and 1983-84. /IF PRESSED: Revised forecasts for later years will probably be available at or after the 1981 Budget./

Defensive

(i) Forecasts of government revenues from the North Sea take account of developments so far this year in world oil prices and exchange rate./Because

1 North Sea revenues with effects of general inflation removed by deflating with GDP market price deflator

Because prospects for these are inherently uncertain, forecast of government revenues in 1981-82 is subject to a wide margin of error.

(ii) How does latest forecast for the real price of oil relate to that used at the time of the Budget?

Budget forecasts of North Sea revenues were based on assumption of a world oil price constant in real terms at roughly the level obtaining at end of first quarter 1980. So far this year, real world oil price has turned out to be a little higher than this; but this has been offset by £ exchange rate being a little higher. Current assumption for 1981 is that real world oil price is likely to remain fairly flat, perhaps rising by 1 per cent year on year.

(iii) Are Government's forecasts for NS revenues too low (as suggested by TCSC)?

No. It is true that some outside forecasters were suggesting much higher North Sea revenues at time of Budget, but these other forecasts have since tended to be revised down, bringing them much closer to the government's projections. (At Budget time outside forecasters had no knowledge of the lower production ranges later published in 1980 Brown Book).

Contact Point: P Sedgwick 233 8931

F3 STOCK RELIEF

Factual

(i) The new scheme announced on 14 November will:-

(a) virtually remove the threat of clawback[1] for continuing businesses;

(b) limit relief to the effects of price changes on a business's opening stocks;

(c) base the relief on the change in a new "all stocks" index;

(d) restrict relief in the largest cases (i.e. where stocks exceed £1 million) to the extent that stocks are financed by trade credit or other borrowings; and

(e) abolish the "profit restriction".

(ii) Cost and distribution: The new scheme will, in present circumstances, give significantly more relief to industry and direct it to those businesses which need it most.

(ii) Full details of proposals in Consultative Document and Inland Revenue Press Notice (both on 14 November).

Positive

(i) Removal of Clawback: A major benefit to industry at a time when many businesses having to reduce stocks to ease liquidity problems. Under new scheme, the threat of clawback will virtually disappear for continuing businesses.

(ii) Extra relief: Scheme will givc significant extra relief. Difficult to be precise: figure depends on level of stocks, profits and rate of inflation. [If pressed: the figure of £300 million/revenue foregone quoted in the press may not be far wrong.]

(iii) Benefit to manufacturing:/ Increases in manufacturing industry's share of relief will increase [from about 45% of total to around one-half. — IF PRESSED].

(iv) Small businesses: Will benefit from ending of - profit restriction; many more will get relief.

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1 Clawback is the recovery of past relief, when the book value of stock falls.

/continued

(v) Tackling misuse of present scheme: New scheme will deal with 2 points which have attracted widespread criticism:-

(a) full relief will no longer be given in respect of increases in volume of stocks (which has encouraged the boosting of stocks at year end);

(b) relief will be abated where large businesses have financed stocks on credit, so that the inflationary costs are borne not by the business but by its suppliers.

Defensive

(i) Credit restriction: This is necessary to withdraw relief from those who do not bear the inflationary costs of holding stocks. And small businesses need not worry about it (because of £1 million threshold).

(ii) Use of single index: The reasons why the Government have opted for this (arguments of principle and practicality) are set out in the Consultative Document.

(iii) Not SSAP 16: Both Statement of current AccountingPractice No.16 on current cost accounting and the new scheme share same broad objective, i.e. to take account of the effect of price changes on profits. The Consultative Document explains why stocks adjustment in SSAP 16 could not be used for tax at present. This does not rule out development of both systems in light of experience.

(iv) The £2,000 de minimis limit: Profit restriction in the present scheme saves a lot of work on small claims where tax is relatively insignificant. The £2,000 will do same.

(v) Stockbrokers Phillips and Drew claim no extra benefit will accrue to business overall and that manufacturers will lose out and retailers gain. They also raise question of current cost accounting.

(vi) Problems over Vesting Clauses

Suggestion that companies might face large back tax bills is being looked at urgently; Ministers will ensure no question of past relief being withdrawn and that stocks concerned will continue to qualify for relief.

CONTACT POINT: Mr McGivern IRD 438-6412

G1: NATIONAL INSURANCE CONTRIBUTIONS

1. Factual

Chancellor announced following changes for 1981-82. (Further details in Bill and Government Actuary's Report published to morrow Tuesday 25 November.)

(i) Employees' Class 1 contributions increased by one percentage point from 6.75 per cent to 7.75 per cent, made up as follows:

- (a) 0.25 per cent to maintain the Fund in balance;
- (b) 0.25 per cent to increase the NHS allocation from 0.4 per cent to 0.65 per cent;
- (c) 0.5 per cent to make up the income lost to the Fund (about £500 million) caused by the reduction in the Treasury Supplement (from 18 per cent of contributions to the NI Fund to 14.5 per cent).

(ii) Contribution paid by employees earning between £27 a week (old rate £23 pw) and £200 a week (old rate £165 pw). Above upper earnings limit, cash contribution remains constant.

2. Employee (not contracted out) individual liability is shown below:-

Weekly earnings £	1980/81 Contribution £	Changes on account of increased earnings limits £	Increases on account of increased contribution rates £	total increases	1981/82 total contribution £
23	1.55	-1.55		-1.55	NIL
27	1.84	-	+0.25	+0.25	2.09
60	4.07	-	+0.60	+0.60	4.67
100	6.77	-	+1.00	+1.00	7.77
130*	8.79	-	+1.30	+1.30	10.09
165	11.14	+0.01	+1.66	+1.67	12.81
200	11.14	+2.36	+2.00	+4.36	15.50

*Approximate current average weekly earnings of full-time male employees.

3. No increase in employers' rate (currently 10.2 per cent) and no change in the NI surcharge (currently 3.5 per cent).

4. Rates for self-employed and voluntary contributors will be adjusted but excluding element 1(i)a above. Other rates to be adjusted as appropriate.

5. Estimated yield will be about £1 billion in 1981-82.

Positive

Reasons for the change

(i) Reduction in Treasury Supplement reduces PSBR in 1981-82. Contributions have to be raised to keep NI Fund in balance;

(ii) Expenditure from Fund will increase in 1981-82 because of the increase in unemployment and higher upratings. Income from contributions no more than expected increased expenditure on benefits.

(iii) Treasury Supplement has stood at 18 per cent of contributions since 1975. Substantial increase in non-contributory (ie. wholly Exchequer-financed) benefits over the years. Government considers appropriate time to readjust balance of financing social security budget between insured persons, employers and general taxpayer.

(iv) Burden of adjustment will fall on insured persons not employers. Employers have taken more than fair share of burden of economic adjustment so far. Ratio of employers' contributions to employees' contributions (excluding NIS) has increased from 1.1:1 to 1.6:1 between 1966 and 1979.

(v) Allocation to NHS has declined as proportion of total health expenditure over years. If Government is to preserve its commitment to maintain spending on health service, contributor must pay more.

Defensive

(i) This is an increase in the tax burden. No. This has nothing to do with tax. Merely asking insured people to finance more of expenditure on benefits and health service from contributions, rather than expecting the general taxpayer to finance them.

(ii) Will you then reduce taxes to compensate? Wait for the Budget. The Chancellor will then consider the tax burden in the wider context in the light of the options open to him. Decisions on contributions are needed now.

(iii) Isn't this regressive? This is the normal way of financing National Insurance. It is progressive between the earnings limits of £27 pw and £200 pw. If pressed. True that NIC bites at lower level of income than income tax; but real increases in income tax are also laid upon the lower paid; especially if they take the form of lowering real tax thresholds.

(iv) The NI Fund has substantial balances, why not use them? That would incur a current deficit on this fund and increase the PSBR. Balance in fund has declined in real value over the years.

SECRET until after
Statement on 24.11.80
THEN UNCLASSIFIED

(v) Why not raise more from e.g. taxes on drink and tobacco? This is not a Budget. Tax options will be considered in the usual way nearer to the Budget.

(vi) Is NI Surcharge affected by these changes? NIS is unchanged. It will continue to be levied, as a surcharge on employers' NICs, at the rate of 3½ per cent on gross weekly earnings up to the upper earnings limit (£200 after April 1981).

(vii) But you are increasing contributions while reducing benefits? Decisions on uprating benefits have little impact on overall finances of NI Fund in 1981-82. Any adjustment in contributions to reflect any lower expenditure on benefits will be considered at next contributions review (November 1981).

(viii) Increase in employees' contributions inconsistent with attempts to hold down wage increases. Main objective is to reduce PSBR; if PSBR inconsistent with our medium-term financial strategy result would be worse inflation.

(ix) Adjustment in Treasury Supplement undermines the basis of the new pension scheme. No effect on new pension scheme. Earnings limits and contribution rebate are not affected by adjustments in Treasury Supplement.

(x) Why not abolish upper earnings limit? Not possible to abolish UEL without significant restructuring since it sets a limit for entitlement to earnings-related pensions and for main pension guaranteed by contracted out schemes.

(xi) How much of increased contribution can be attributed to higher unemployment? Wait for the Government Actuary's report. As the Industry Act forecast indicates, thelevel of unemployment is expected to be higher in 1981. Government Actuary has been asked to assume that average level of GB unemployment in 1981-82 will be 2.3 million excluding school leavers.

Contact Point: D Butler (SS1) - 233 - 3932

H1 PUBLIC EXPENDITURE: 1981-82

(All figures are in 1980 Survey Prices)

Factual

(i) The Government has now completed its review of the expenditure plans for 1981-82 as part of the normal public expenditure planning cycle.

(ii) The main underlying problem which it has had to face has been the effect of a recession which is rather steeper and heavier in its impacts on both sides of the public accounts than foreseen earlier.

(iii)Allowance has to be made for substantial increases in certain open-ended programmes, eg. social security expenditure.

(iv) The external financing limits for nationalised industries (excluding British Steel) have been increased by £620 million, reflecting the deterioration in trading conditions. The industries are being required to secure substantial economies of more than £750 million.

(v) There is an increase of £245 million in provision for special employment measures and some £50 million in provision for selective assistance for investment and support for industrial research and development.

(vi) Substantial reductions of nearly £1.1 billion have been made to other programmes. Main reductions include:

	£m
Local Authority current expenditure (3% rather than 2%)	165 (England)
Defence	200
Social Security - not carrying forward excess uprating and other measures	66

(vii)RSG 1981-82 to be calculated on basis of lower percentage than present 61% England and Wales (68% Scotland). Government will consult local authorities. /IF PRESSED: "lower percentage" means maximum of 60 per cent (England and Wales)./

(viii)There will be European community refund in 1981-82 of some £650 million.

Positive

(i) Government maintains its commitments to reduce the volume of public expenditure in the medium-term. Volume of planned expenditure is being redistributed, with substantial reductions in some programmes partly offsetting increases due to the recession.

(ii) Cash limits are being set to slow down very sharply the rate of growth of costs, especially on public service pay.

(iii)Shift away from the plans of the previous administration made last year is being sustained although some adjustment to the earlier plans to take account of the changed economic circumstances is now thought appropriate. Planned total for next year will still be some £5 billion below level planned by previous government.

(iv) Aim is to keep planning total for volume of public expenditure in 1981-82 about 1% below outturn now expected for the current year.

Defensive

(i) Final planning total has not yet been set - that will be included in next public expenditure White Paper. Precise figure will depend both on economic assumptions then thought appropriate and on decisions still to be taken (notably British Steel Corporation EFL and child benefit).

/BACKGROUND INFORMATION: figures quoted by Chancellor for outturn for this year and aims for next year point to planning total in the range of £78 billion - £78.5 billion. The press can be helped with this arithmetic, but no official imprimatur should be given to a specific figure at this stage - that is for the White Paper to do./
For comparison of 1980 survey prices with Cmnd 7841, see Press Notice.

(ii) White Paper will be published with Budget, when it can be set against tax plans, and when remaining decisions both for next year and following years have been taken.

(iii)Present statement is about the expenditure decisions which have to be taken at this stage if the various spending authorities - nationalised industries, local authorities, health authorities, Government departments etc - are to have time to put the plans into effect.

(iv) The services breakdown of reduced volume plans for LA current spending will be given in the RSG consultative document later this year.

(iv) Rate increases need not be excessive - despite lower RSG support - if councils plan in line with cost targets on volume, and stick to tough pay bargaining posture. Manpower may be key to success.

Contact Point: Miss M Peirson 233 7208

/H1 ANNEX

SECRET

until after Statement 24.11.80

H1 (Annex)

SUMMARY OF PUBLIC EXPENDITURE POLICY DECISIONS

A. Volume

1. The changes in expenditure programmes for 1981-82 due to policy decisions since the March Public Expenditure White Paper (Cmnd 7841) are:

	1981-82 £m at 1980 Survey Prices (b)	
Nationalised Industries		
Increases in EFLs (other than for British Steel) including revised provision for shortfall		+620
Other policy increases (a)		
Special employment measures	+245	
Industrial support	+ 52	
Industry (other)	+ 10	
Health (withdrawal of some proposals for new charges)	+121	
Civil superannuation (accelerated retirement of civil servants)	+ 64	
Trade	+ 21	+510
Other significant policy changes: (a)		
(i) Local Authority Current Expenditure (England) - reduction by about 3% instead of 2% from planned level for 1980-81	-165	
(ii) Further changes in Departmental programmes (excluding elements of local authority current expenditure included in (i))		
Agriculture Departments	- 36	
Department of Employment	- 25	
Department of Transport	- 21	
Department of Environment (including PSA)	-158	
Home Office	- 17	
Department of Education and Science	- 52	
Office of Arts & Libraries	- 10	
Department of Health & Social Security (health)	- 25	
(iii) Other Departments		
Defence	-200	
Foreign & Commonwealth Office	- 16	
Export Credits Guarantee Department	-166	
Department of Health & Social Security (social security)	- 66	
Scotland, Wales and N. Ireland (including changes to local authority current expenditure in Scotland and Wales)(c) (about)	- 90	
Other (about)	- 15	-1,060
EC refund agreed on 30 May 1980		- 650

/ Footnotes - see next page

2. The changes take account of the salary savings expected in 1981-82 from the progressive reductions in Civil Service numbers to 630,000 by 1984.

3. The list does not include changes where the exact amount will be decided later eg British Steel and Child Benefit. Nor does it include the estimating adjustments, eg for demographic and economic factors, which will be made in the public expenditure White Paper to be published at the time of the Budget. The White Paper will include further details of the policy changes for 1981-82 and will set out the plans for 1982-83 and 1983-84.

4. The figures are in the prices used for the 1980 Public Expenditure Survey. "1980 Survey Prices" means for most expenditure broadly the prices of late 1979, which were some 18 per cent higher than the 1979 survey prices used in Cmnd 7841. For transfer payments (including overseas aid), 1980 survey prices are generally estimated average prices for 1979-80, ie about the same as those in Cmnd 7841, as a result of a change of definition since that White Paper.

B. Cash limits

5. Cash limits and Votes for expenditure other than pay will allow for an average level of prices in 1981-82 11% higher than the corresponding level in 1980-81.

6. The cash limits for the Rate Support Grant and for the Universities' Grant will include allowance for increases in earnings of 6% in annual settlements due before 1 August 1981, and also provisionally of the same amount for annual settlements due after that date. The allowance for pay in other cash limits, and Votes, will be so set that the pay of the relevant groups is dealt with broadly within the same financial disciplines. The outcome of settlements in particular cases will depend on the way in which the cash is allocated.

Contact Point: Miss M Peirson 233 7208

(a) The increases and reductions shown include the net effect of various minor policy changes.

(b) Total changes are rounded to the nearest £5 million.

(c) The exact changes to Scotland, Wales and Northern Ireland programmes, in parallel with those to English programmes, will be given in due course.

H2 1981-82 CASH LIMITS

Factual

(i) The rate support grant cash limit will provide for 6 per cent annual increase in earnings from due settlement dates. On expenditure other than pay it will provide for increases in prices of 11 per cent between the average level of 1980-81 and 1981-82.

(ii) Exepnditure in other parts of the public service will be handled within broadly the same financial disciplines.

(iii) As made clear in Chancellor's letter of November 24 to Mr du Cann, (reproduced in Treasury Press Notice) Government will discourage staging or delaying implementation of pay awards. Cash limits will be set to ensure that no financial advantage can be gained in this way.

Positive

(i) It is the Government's policy that pay should be negotiated in the framework set by cash limits. Cash limits reflect what can be afforded.

(ii) 6 per cent is not a pay norm. It is for managers to decide how to allocate the money available. Earnings increases can be higher or lower. If they are higher it will be necessary to make offsetting savings e.g. through further manpower economies ~~or~~ on other expenditure. If they are lower it will be easier to achieve departmental programmes.

(iii) Staging can be a way of avoiding the discipline of cash limits. It enables wage bill to be accommodated in one year's cash limit at expense of carrying additional costs forward to following year.

(iv) If an award is staged in future, the cash limit will be set so that the element of the cost deferred into the following year by staging willmean that correspondingly less cash is available for the new pay award in that year.

/H2 continued

Defensive

(i) No decisions have been announced to apply the 6 per cent provision to pay other than to local authority employees.

(ii) 6 per cent relates to earnings. Implication for settlements depends on the circumstances for individual groups.

(iii) Figure of 6 per cent applies to settlements falling in 1981-82 and in the remainder of 1980-81. For settlements after 1 August 1981 (i.e. next pay round) is provisional. Government will decide what can be afforded for public service settlements in next pay round nearer the time.

(iv) 11 per cent is consistent with the RPI figure in the Industry Act forecast. It relates to particular transactions of the public services, not to retail prices generally. Based on increase between financial years, not between fourth quarters.

(v) Squeeze on volume of expenditure in 1980-81 is always possible. It depends on actual price increases on the particular goods concerned. It is not anticipated that these factors will produce any significant squeeze.

(vi) Certain awards were staged in the 1979-80 pay round. Provision will be made in 1981-82 cash limits for the staged element in these awards. They were entered into in good faith and it would not be appropriate to apply a retrospective penalty by refusing to provide for extra cost in 1981-82.

(vii) Providing for awards staged in 1979-80 pay round will add some £275 million, or about 1 per cent to public service pay bill in 1981-82. Groups concerned are teachers (over £200 million), non-industrial civil servants (about £60 million) and university staff (about £15 million).

(viii) Increase in public services paybill between 1980-81 and 1981-82 depends on planned numbers, settlement dates and financing of staging. Financing past staging adds about 1 per cent to the paybill. For public services as a whole the increase is likely to be around 7 per cent but this will vary for individual groups.

/H2 continued

(ix) Public service employees real pay being reduced? Workers throughout the economy likely to find have to take reductions in real earnings. Public services have had substantial rises recently. They enjoy greater job security.

(x) How will public services pay/rises compare with others? This is what public service employers can afford. Private sector workers must settle for what their employers can afford.

CONTACT POINT: S A ROBSON 233-8633

H3 PUBLIC EXPENDITURE 1980-81 (All figures current prices)

i. Factual

(i) The volume of public expenditure in 1980-81 is now expected to be some 1½% above the levels in the last public expenditure White Paper (Cmnd 7841).

(ii) The FSBR put the estimated outturn on Cmnd 7841 planning total after shortfall at £91.6 million. (Table 16 of Red Book)

(iii) On top of the increased volume of expenditure there have also been additions to public spending arising from pay and price increases; the most notable example is the £203 million increase announced in the defence cash limit.

(iv) There have been 40 changes to cash limits so far this year giving rise to a net increase of £220 million on a cash limits total of some £46½ billion.

(v) The main increase to cash limits have been defence (+£203 million), fisheries aid (+£13 million) and Northern Ireland (+£16 million). The main reduction Energy R & D (-£16 million) and labour market services (-£10 million).

Positive

(i) Cash limits are being respected. Expenditure is being closely and effectively monitored. There have been difficulties on defence, on local authority current expenditure and on local authority capital expenditure on housing. In each case the problems were quickly identified and action taken.

(ii) In certain areas expenditure programmes are necessarily open-ended and cannot be subject to cash limits or controlled within the year eg social security expenditure depends on unemployment. The depth of the recession is increasing expenditure in these areas.

(iii) Winter Supplementary Estimates (to be presented to the House on December 2) have been taken fully into account in the Chancellor's statement and in the Industry Act PSBR forecast for 1980-81.

Defensive

(i) Major extra cash needs for volume increases in the planning total include special employment measures (+£200 million), agricultural support (+£100 million), social security (+£350 million) and reduced shortfall (+£800 million). To be set against this there is the EC refund of £650 million.

(ii) These increases reflect the increased numbers of qualified recipients (employment measures, social security) and harvests (agriculture). Part of the reduction in shortfall reflects the speed at which work is being done by industry in the recession.

(iii) In addition to the increase over the planning total the PSBR is also raised by additional debt interest (+£500 million) and also by increased spending arising from pay and price rises (eg defence cash limit increase of £203 million).

(iv) There have been other increases in the volume of programmes arising from decisions. These have been met from the contingency reserve and so do not add to the planning total in Cmnd 7841 or to the PSBR. Major examples include the increases in the EFLs for British Shipbuilders (£65 million), British Steel (£400 million) and British Rail (£40 million).

CONTACT POINT: MR ROBSON 233-8633

H4 CASH LIMITS 1980-81

Factual

(i) The 1980-81 Rate Support Grant cash limit provided for 13% increase in costs between 1979-80 and 1980-81 arising from price increases and new pay awards.

(ii) Other cash limits provided for 14% increase in earnings from due settlement dates as result of new pay awards. On current expenditure other than pay, provision was made for 14% increase in prices between 1979-80 and 1980-81. Somewhat larger provision was made for price increases on capital expenditure.

(iii) There have been 49 changes to cash limits so far this year, giving rise to a net increase of £220 million against a cash limit total of some £46½ billion.

(iv) The main increases to cash limits have been Defence (+ £203 million) Fisheries aid (+ £13 million) and Northern Ireland (+ 16 million). Main reductions have been energy R & D (-£16 million) and labour market services (- £10 million).

Positive

(i) Expenditure this year is not out of control. It is being closely and effectively monitored.

(ii) There have been difficulties on defence, on local authority capital expenditure on housing and on local authority current expenditure. In each case the problems were quickly identified and action taken.

(iii) Cash limits are being respected.

(iv) In general, increases to cash limits have been met from contingency reserve and so within planned levels of public expenditure and PSBR.

/continued

(v) Winter Supplementary Estimates (to be presented to the House on 2 December) have been taken fully into account in the Industry Act PSBR forecast for 1980-81.

Defensive

(i) The increase in the defence cash limit was not charged to the contingency reserve. As a result this fell on the PSBR. The reserve is a control on decisions to add to the volume of expenditure; the increase in the defence cash limit reflected pay and prices and was not an addition to the volume of the programme.

(ii) Local authorities may respond to the witholding of £200 million rate support grant by equivalent extra borrowing. This would mean no benefit to the PSBR. Aim of the witholding arrangement is to give authorities every incentive to reduce spending and so benefit the PSBR.

CONTACT POINT: S A ROBSON 233-8633

H5 NATIONALISED INDUSTRIES' EFLs

Total External Finance

	1979-80	1980-81	1981-82
	£million 1980 Survey prices		
1. Cmnd 7841 revalued	2,700	1700	750
2. Announced change in 81-82	-	-	+620
			1570

Factual

(i) The announced change for 81-82 does not include provision for BSC. This will be announced following receipt of the industry's Corporate Plan. Provision for the remaining industries has been increased by £620 million which reflects the impact of adverse trading conditions at home and abroad, offset by substantial economies in each industry's requirements. Three quarters of this has been met by removal of the standard shortfall allowance (£470 million) asssumed in Cmnd 7841.

(ii) Individual cash limits corresponding to this provision are being separately announced by the CST in a Written Answer PQ (on 24 November).

Positive

(i) The industries have made a substantial contribution to the overall adjustment needed for 81-82. They have been required to secure economies of more than £¼ billion in order to limit their increased provision to that shown in line 2.

Defensive

(i) Investment. The cuts in investment which these economies may involve should be relatively small in relation to the industries' overall spending on investment (about £5,000 million). Their investment programmes have not been cut back with the severity of much of the private sector; on the other hand, it is right that they should take some of the burden of adjustment which would otherwise fall entirely on the private sector.

(ii) Pay
A rigid pay assumption has not been imposed on the industries; pay settlements are the responsibility of the industries

/H5 continued

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themselves and will reflect the different circumstances of different industries. Nevertheless individual industries assumption for pay, along with other key assumptions, have been discussed with them and external financing levels have been set on the assumption that each industry will reach reasonable pay settlements this round, broadly comparable with those likely to be reached in the private sector.

(iii)/ Prices In context of general inflation, further rises in NI prices are inevitable, and effects of these are taken account of in the figures. But rate of increase of NI prices is expected to slow down markedly in coming year.

Efficiency

(iv)/ Recent Monopolies and Merger Commission Reports indicate that there may be substantial scope for improving efficiency in the NIs. To the extent that the economies required can be met in this way, reduction in investment or price increases, can be avoided.

(v) Nationalised industries "off course"? Critics at TCSC hearings in spring were right?

We said at the time that the estimates for the nationalised industries external financing requirements were very uncertain, since they depend on trading conditions. But it remains Government's intention to achieve a substantial turn-round in the nationalised industries' financial position.

Questions on individual industries should be addressed to sponsor departments.

Contact point: C R SMALLWOOD 233-3980

H6 DEFENCE

	£m 1980 Survey prices		
	1979-80	1980-81	1981-82
1. Total programme Cmnd 7841 (revalued)	9290	9616	9942
2. Announced change in 1981-82			-200

Factual

(i) /(Background: NOT FOR USE)

There is a difficulty in expressing the increase in 1981-82 which will result from the cut. 1980-81 baseline is uncertain: it depends by how much MOD exceed their cash limit. For purposes of this announcement we assume in calculating increase from 1980-81 to 1981-82 that MOD stick to the cash limit of £10,492 million, which would give them estimated volume outturn of £9500 million at 1980 survey prices. If, as we privately expect, they exceed cash limit by substantial amount there could be actual decline in real size of defence programme between 1980-81 and 1981-82. But increase in the two years taken together will still be nearly 5%./

(ii) Outturn for current year still uncertain: there is a danger, as has been recognised, that the cash limit of £10,492 million will be exceeded. For purpose of calculating increase (2½%) from 1980-81 to 1981-82 Chancellor has used estimated outturn for 1980-81 which would be consistent with cash limit (£9,500 million at 1980 Survey prices).

Positive

(i) Defence expenditure grew by 3% in 1979-80 and is expected to grow by some 2½ per cent both this year and next.

(ii) UK's performance in relation to NATO 3% target compares favourably with other European allies. UK devotes greater share of national income to defence than any of major European allies. Defence expenditure continues to rise strongly under this Government, in marked contrast to declining trend under Labour.

Defensive

(i) NATO target is to aim at "real annual increases in the region of 3% pa". UK will be doing just that. Many Allies have fallen short of it with much less justification than UK's current economic situation would provide.

(ii) Any cuts affecting defence procurement must have industrial consequences, but defence industries will still be faring better than manufacturing industry in general.

Contact point: C J A Chivers 233-8119

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H7 SOCIAL SECURITY

	£ million 1980 Survey prices 1979-80	1980-81	1981-82
1. Total Programme Cmnd 7841 revalued	19,272	19,731	20,183
2. Announced change in 1981-82			- 66

Factual

(i) Lines in table do not represent resulting programme. There will be significant likely additions to it in respect of revised economic assumptions - mainly effect of paying unemployment benefits to higher number of unemployed.

(ii) Abatement of public service pensions applies to those pensions linked to the State retirement pension by the 1971 Pensions (Increase) Act. Broadly this covers retired civil servants, NHS workers, teachers, police, firemen, local government officers, judges, MPs and Ministers. Also covered are ex-members of the Armed forces whose increases are made by Royal Warrant. Does not directly affect other public sector bodies of most of nationalised industries.

Positive

(i) Government has kept to its commitment to maintain real value of retirement pension over time. Most of net announced change in 1981-82 is from decision to uprate pensions and other benefits in November 1981 by one percentage point less than movement of prices over that year, to take account of increase in real value of benefits at November 1980 uprating.

(ii) Expenditure on social security in 1981-82 will still be over £20 billion, and increase over 1980-81.

Defensive

(i) Social security programme takes quarter of public expenditure; could not therefore be exempted from need to secure economies.

(ii) Amounts saved are most that could be secured without breaking Government's commitments to pensioners and to protect those most in need.

(iii) Uprating of benefits announced at Budget time and paid from 24 November 1980 was 16½ per cent for most benefits. (This was forecast movement of prices between November 1979 uprating and

continued

November 1980). We now expect prices movement over that period to be 15½ per cent. So there has been an increase in the real value of benefits. We do not expect earnings in 1981-82 to increase as fast as prices. At this time we cannot afford for those out of work to have real advantage over those in work. But Government wishes to maintain its pledge to protect real value of pensions over time. Hence decision to take back 1980 overpayment at November 1981 uprating.

(iv) Those who receive less than full price protection at November 1980 uprating (unemployment benefit, sickness benefit, invalidity benefit and maternity allowance) will be treated in same way as retirement pensioners and others. Decision to abate their uprating was related to the decision to bring them into tax (UB from April 1982, other benefits as soon as possible thereafter). Position will not have changed at November 1981 uprating.

(v) Certain benefits are exempt from the one percentage point. They include war pensions, mobility allowance and attendance allowance. There will be no change in other benefits which are not uprated every year (e.g. maternity grant,death grant etc).

(vi) Decision on uprating of child benefit will be taken at Budget time. Announced changes make no assumption about level of child benefit.

CONTACT POINT: C D BUTLER 233-3932

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J1

J1 LABOUR PARTY/TUC

Factual

(i) Labour and trade unions concerned over decline in business activity and high unemployment; blame Government's fiscal and monetary policies as deflationary; expect 3 million jobless next summer (Mr Healey).

(ii) Labour and trade unions say monetary policy too tight; call for reduction in interest rates (Mr Healey: 4% off MLR).

(iii) Labour and trade unions have criticised public spending cuts; call for more spending on industry and special employment measures.

(iv) Labour Party and TUC have urged higher PSBR during recession (Mr Healey: £3-4 billion above PSBR forecasts):

(v) Government accused of using unemployment to moderate pay after exacerbating inflation by own actions (nationalised industry price rises; VAT increase in June 1970; local authority rates and rents).

(vi) TUC Council and some Labour spokesmen favour an incomes policy but Congress in September voted for free bargaining.

(vii) Present over-run on money supply means, on Government premises, rising inflation will re-emerge in 1981/82 while present fall in inflation rate reflects last Government's monetary control.

(viii) Both TUC and Labour NEC call for controls on imports.

Positive

(i) Chancellor's statement re-affirms strategy that economically responsible Opposition members recognised as necessary - at least when in office.

/continued

(ii) Interest rates: See D1

(iii) Inflation now on firmly downward trend.

(iv) Expansion of special employment measures; selective assistance for investment; support for industrial research.

(v) Opposition spending plans were unrealistic.

Defensive

(i) Higher National Insurance contributions. Appropriate for those in work to help finance benefits for jobless and those in good health to pay more towards cost of NHS.

(ii) Public spending cuts: needed to check PSBR and allow monetary targets to be met without excessive interest rates. 6% figure in cash limits not an incomes policy: right to look for much lower growth in public service earnings in the coming year than the recent past. Both are necessary to fiscal policy.

CONTACT POINT: MISS DEYES 233-7426

J2 CBI AND BUSINESS INTERESTS

Factual

(i) Support expressed for Government aims of bringing down inflation and creating conditions for trading sector of economy to flourish. But critical of some details and timing of strategy.

(ii) High interest rates: 4 percentage points off MLR request by CBI President (also West Midlands group of Chambers of Commerce) now reduced to "significant" cut in excess of 1 percentage point.

(iii) High exchange rate: seen as linked with high interest rates and a burden on exporters.

(iv) National insurance surcharge: seen as penalising home products vis à vis imports.

(v) Private sector felt to be bearing brunt of recession. Government is urged to do more to cut public spending, public sector pay and public sector employment and get borrowing down to relieve pressure on interest rates.

(vi) Use of North Sea oil revenues - should be used to finance tax cuts that would benefit business, not to finance living standards.

(vii) Energy costs for UK industry - disproportionate to those in competitor countries.

Positive

(i) Interest rates - see D1.

(ii) MTFS strategy to bring down inflation re-affirmed. Offers best prospect for business in longer term.

(iii) Government determined to keep public spending, public sector borrowing and monetary growth in check. Firm stand on public sector pay.

Defensive

(i) Spending cuts inadequate?

Government still committed to lower public spending in medium term.

(ii) Spending cuts harmful to industry? Excessive public spending and borrowing worse for industry in long run.

(iii) Exchange rate suggestions for direct action misguided. See C1.

(iv) NIS - brings in substantial revenue; reduction would have to be financed from some other source.

(v) Revenue raising from petroleum production and concentration of national insurance increase on employees mean no extra burden on hard pressed sector of private industry.

(vi) Energy Costs

Government willing to discuss energy price anomalies with fuel industries and press other Governments to eliminate any energy subsidies. But energy prices must reflect marginal costs of supply.

Contact Point: Miss M M Deyes 233 7426

J3 POVERTY/CONSUMER PRESSURE GROUPS

Factual

(i) Child Poverty Action Group and others argue against reducing real value of social security and/child benefit.

(ii) National Council of Voluntary Organisations want expanded programmes to help young and long term unemployed; last report from Supplementary Benefits Commission predicted social conflict.

(iii) Low Pay Unit and others continue to worry about numbers depending on low incomes from work, and likely to lose jobs.

(iv) National Consumer Council wants ceiling on nationalised industry price rises.

Positive

(i) Inflation coming down; this is especially important to worst-off: Chancellor's statement affirms strategy to achieve lasting reduction in inflation.

(ii) Increase in pension this week 16½%; we now expect November 1979 to November 1980 price increase to be 15½%.

(iii) Defeating inflation essential for strong economy, more jobs, higher incomes and wealth creation to finance support of families, pensioners etc.

(iv) Measures to help young and long term unemployed expanded.

Defensive

(i) Next year's increase in pensions one percent under expected price rise: justified by this year's up-rating one percent above actual price rise.

(ii) National insurance contributions increase: see G1. Frank Field (former CPAG director) conceded in recent letter to Financial Times right for workers to pay more towards financing benefits for jobless.

(iii) What about child benefit? Wait for the Budget.

(iv) Nationalised industries: some price rises inevitable but rate of increase should be slower in coming year.

Contact Point Miss M M Deyes 233 7426

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J4 CONSERVATIVE PARTY CRITICS

Factual

(a) Some critics want more curbs on public sector spending, especially pay, to bring down PSBR (Mr Critchley, Mr Higgins, Mr du Cann).

(b) Some concerned about industry and unemployment urge relaxation of monetary policy and lower interest rates (Monday Club Mr Rippon, Mr Heath). Mr Macmillan in TV interview called for some reflation.

(c) Some concerned about effect on industry of high exchange rate (Mr Lewis, Mr Dorrell, Mr Baker, Mr Higgins). Tory Reform Group paper calls for "balance of payments policy".

(d) Some criticise form taken by spending cuts (Mr Rippon wants concentration on current spending Mr McCrindle wants to save social services even at a cost of raising taxes; Mr Churchill critical of defence cuts).

(e) Many critical of suggestion of raising taxation; Mr Latham wants tax cuts to boost demand and encourage pay moderation: Mr Latham and the two Pattens want cut in NIS

Positive

(i) Interest rates - see D1

(ii) MTFS strategy to bring down inflation reaffirmed.

(iii) Government determined to keep public spending, public sector borrowing and monetary growth in check.

Defensive

(i) Suggestions for action on exchange rate remain misguided - See C1.

(ii) Revenue raising from petroleum production and concentration of national inusrance increase on employees mean no extra burdens loaded on hard pressed sector of private industry.

(iii) Defence spending still rising strongly. UK meeting NATO target.

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