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

TREASURY WEEKLY ECONOMIC BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 7 March, are sidelined. Some Sections appear in typescript because of temporary problems attending re-location and re-equipment of the Word Processing Unit.

EB Division
HM Treasury
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RA

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15 March 1982

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6. Budget not expansionary enough?

Growth depends not on tax handouts or higher public spending, but on lower inflation and better competitiveness. Budget is directed at these. Lower world oil prices have similar effects on industrial costs as cut in NIS and reduce need for additional measures. [IF PRESSED: Budget should be seen in context of December measures - £5 billion increase in planning total for 1982-83.]

7. Budget far too expansionary?

Changes relative to some hypothetical alternative pretty meaningless. What matters is that in planning PSBR for 1982-83, Government has stuck closely to MTFs.

8. Reflationary/deflationary/effect on demand?

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

9. Not enough help for industry?

Glad to see (from FT Survey) that most industrialists pleased with Budget (see N2). Main help for industry is in pursuing policies that allow for lower inflation and ease pressure on interest rates. But in addition, Budget measures aimed at industry and business with cost over £1 billion in 1982-83. Setting aside revalorization of personal tax allowances etc and specific duties, over two thirds of net revenue cost of Budget changes go to help business. Minor measures aimed where do most good. Also remember protection for industry from 2 years of employees' NIC rate increases, worth £1 billion a year (or another 1 per cent off NIS).

10. Fiscal policy should be based on real PSBR?

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

11. Fiscal policy should be based on cyclically adjusted PSBR.

Actual not hypothetical PSBR has to be financed. Real test is pressure on interest rates. Adjusted PSBR calculations provide only limited and partial help in assessing direction of policy.

12. Another Budget pushing up prices?

No. Changes in excise duties slightly less than required for full revalorisation. 12-monthly inflation rate forecast to fall to 9 per cent by November 1982.

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

See Section D.

14. Does more for industry than for people?

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

15. Not keeping to commitments to reduce expenditure?

Increases announced in Budget offset by reductions leaving totals still around £115 billion. FSBR shows declining ratio to GDP in future years.

16. Armstrong/unified Budget?

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

17. MTFS abandoned?

[Mr Heath's claim (Weekend World 14 March) that 'monetarism is dead']

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

(i) Signs of recovery

- Total output (GDP) rose in both 3Q and 4Q 1981. Level in 4Q some 1 per cent above 2Q.
- Short time working in manufacturing fell in 1981 to below 1/4 its January peak;
- 1981 figures show volume of engineering and construction orders up about 17 and 9 per cent respectively on 2H 1980.
- Private sector housing starts in 1981 up by 37 per cent on 2H 1980.
- Most recent major independent forecasts assess low point in activity reached in 1H 1981; prospect of some recovery in 1982.

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

(iii) Productivity. Output per head in manufacturing rose 10 per cent during 1981. Investment in plant and machinery holding up well.

(iv) Unit labour costs: Pay moderation and higher productivity has meant dramatically low increase in manufacturers unit wage costs over last year - just 2½ per cent in year to 4Q 1981.

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

(vi) Profits: Non North Sea industrial and commercial companies gross trading profits (net of stock appreciation) rose some 13 per cent in 3Q.

(vii) Exports holding up well; non-oil export volumes in 4 months to December up 3½ per cent on 1980. 1981 figures (incomplete) show engineering export orders up 20 per cent on 2H 1980.

(viii) Unemployment. Rate of increase in unemployment since mid 1981 about half that in 1H and 1/3 that in 4Q 1980. Vacancies improving since mid 1981. Short-time working in manufacturing reduced by over ¼ during 1981 and overtime working has increased.

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

- (x) Training. Over next 3 years £4 billion to be provided to bring training schemes up to date. New Youth Training Scheme for school leavers to be introduced September 1983 represents major step towards comprehensive provision for young people.
- (xi) Industrial relations. Number of strikes in 1980 and 1981 less than in any year since 1941 and number of working days lost only a third of average of last ten years.
- (xii) Retail prices. Inflation almost halved since peak in spring 1980 (21.9 per cent). 12 monthly increase in January of 12.0 per cent. [NB Progress affected by lower exchange rate.]
- (xiii) Share Ownership Schemes: Number of schemes has increased from 30 in May 1979 to over 400. Number of employees covered roughly doubled between first and second years in office. Profit sharing schemes alone now cover about $\frac{1}{4}$ million employees.
- (xiv) Loan Guarantee Scheme. Over 2700 guarantees issued so far on loans totalling just under £100 million. Well over half of loans going to new businesses.
- (xv) Enterprise Zones. 10 out of 11 zones already in operation. Last one (Isle of Dogs) expected to start in April.
- (xvi) Examples of export successes reported in the Press include: £160 million contract for construction of two new colleges in the largest ever such contract between Britain and Nigeria (Mitchell Cotts Group); approved tender for veterinary vaccines to Kampuchea (~~Hoechst~~ UK); supply of 1000 special gearboxes to Istanbul within five weeks of order (Turner-Spicer Transmissions); travelling hoists with exceptionally low headroom (550mm) for use in Danish oil and gas exploration platform in North Sea (Tonnes Force); a profiled metal cladding system for a power station in The Gambia (Ash and Lacy Steel); and glazing for the new Financial Complex in Port of Spain - the biggest ever such gained by a UK glass processor (Clark and Eaton with Pilkingtons). New British-designed, managed and partly funded, domestic water supply project in Jordan was opened by King Hussein on 18 February.
- (xvii) UK preferred location: US electronics industry survey reports UK most preferred location for establishing new plants.
- (xviii) Overseas debt repayments. Official external debt reduced from over \$22 billion, when Government took office, to \$13.3 billion at end-1981.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent position?

Recovery confirmed by second successive quarterly rise in total output. Output in Q4 1 per cent up on Q2 - the earlier low point.

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

2. Recent manufacturing production figures show resumed decline?

[January figures show further fall in industrial and manufacturing production, now 3 and 4 per cent respectively below October levels, with manufacturing production at lowest point since 1967]

Only to be expected that January's index would show some further weakening. Series of factors (car and rail strikes, bad weather, holidays) have distorted the last three months. Despite this, manufacturing output in Q4 1981 some 2-3 per cent higher than its low point earlier in the year (Q1 1981). Preliminary indications for February suggest a pick up, with steel and car output up 16 and 12 per cent respectively, compared with January.

3. Other evidence of improvement in economy?

Engineering and construction orders and private sector housing starts all well up during 1981 on H2 1980. Productivity (output per head) in manufacturing rising strongly - up 10 per cent in Q3 1981 from Q4 1980. Exports doing well (see K4). (Labour market indicators -see C1).

4. Government assessment of prospects

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

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

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

FSBR forecast sees prospect of some recovery continuing into 1983. (Last two Government assessments of economy were broadly correct). Healthy rise in private sector investment and exports. Inflation well into single figures ($7\frac{1}{2}$ per cent) by mid 1983. Further progress depends on continued moderation in domestic costs and restoration of competitiveness.

5. Outside forecasts

[GDP profile in recently released major forecasts:

	<u>NIESR</u>	<u>LBS</u>	<u>CBI</u>	<u>Phillips & Drew</u>	<u>OECD</u>	<u>FSBR</u>	
	(Feb)	(Feb)	(Nov)	(Mar)	(Dec)	(Mar)	
Per cent change 1982 on 1981	+1 $\frac{1}{2}$	+1 $\frac{1}{2}$	+1	+1 $\frac{1}{4}$	+ $\frac{1}{4}$	+1 $\frac{1}{2}$]

Most recent major independent forecasts assess that low point in activity was reached in first half of 1981, with prospect of some recovery in 1982. As always, a range, with Cambridge forecasts being the more pessimistic. Most outside forecasters have not yet published their post-Budget assessments. Only major forecasters who have (Phillips and Drew) have revised their forecasts to show higher output and lower inflation arising from Budget measures and lower oil prices.

C LABOUR

1. Recent unemployment figures?

[February total count was 3,045,000 (12.6 per cent) down by 26,000 on January. Seasonally adjusted excluding school leavers figure was 2,836,000 (11.7 per cent), a rise of just 7,000 on January.]

Figures so far this year distorted by severe weather. Average monthly increase in January and February together about 30,000 (after allowance for over 60's transferring to long term Supplementary Benefit). Compared with 40,000 a month in H2 1981 this suggests a further slowing down in rate of increase (but figures have been affected for almost half a year by series of distortions - bad weather, civil service strike).

2. Effect of Budget on unemployment?

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

3. Unemployment expected to continue rising rapidly?

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

Unemployment forecasts uncertain; independent forecasters encompass differing views for 1983 - with several projecting stabilisation and Liverpool some decline. Rise in unemployment drastically reduced since end 1980. Tentative evidence of further slowing down this year - January/February rise just $\frac{1}{4}$ than in Q4 1980. Vacancies, short time and overtime all improved last year. Employment situation will benefit from some further recovery in activity this year.

4. Government forecasts for unemployment

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

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

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

5. Employment continuing to fall?

[Total employment declined 1.9 million or 8 per cent in 2 years to Sept 1981. Q3 figures indicate decline of 150,000 compared with 300,000 per quarter in H1 1981. Manufacturing employment declined by 34,000 a month in Q4, a little more than Q3.]

Third quarter decline in total employment half that in H1 1981. Manufacturing employment statistics suggest that lower rate of decrease was maintained in fourth quarter.

6. Unemployment higher than in other countries?

[On standardised definitions in 3Q 1981 UK employment was 11½ per cent compared with 6¼ per cent OECD rate; a UK doubling compared with an OECD rise of a third since 1979.]

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

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

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

8. What is Government doing to provide more jobs?

Illusion to think Government can switch employment off and on like a tap. Government pursuing sensible fiscal and monetary policies to curb inflation and creating conditions for enterprise. These are only measures that will ensure sustainable increase in employment.

Nevertheless Government expanding schemes to meet special difficulties and improve training - eg plan to spend £1½ billion in cash on 1982-83 (40 per cent more than in 1981-82) on special employment and training measures; new Youth Training Scheme costing £1 billion a year from 1983-84; and new measure announced in Budget. (See C2.)

9. What has Government done to make labour market more flexible?

Have taken action on a number of points:

Training: extra spending on 16-17 year olds; plans to reform apprenticeship system; White Paper on New Training Initiative sets out action required in industry and education as well as lead from Government to bring system of industrial training up to date.

Young workers: subsidy to employers to take on youngsters at lower wage rates - object to price young back into labour market.

Mobility: Housing Act 1980 provisions for short-term tenancy in private rented sector.

Employment Act 1980 measures to reduce costs of employment and rigidity in wage-setting practices.

Employment Bill 1982 designed to bring about further improvement in labour relations.

D TAXATION

1. Burden of taxation

[Total taxation (i.e. including for example indirect taxes, income tax, NIC, corporation tax and rates) in 1978-79 was $34\frac{1}{2}$ per cent of GDP (at market prices), 36 per cent in 1979-80, $37\frac{1}{2}$ per cent 1980-81. It is forecast to be 40 per cent in 1981-82 and $39\frac{1}{2}$ per cent in 1982-83.]

This has inevitably increased during a time when the recession has been adding to public spending. My Rt Hon Friend the Chancellor has now been able to propose changes which will reduce the burden next year compared with 1981-82.

2. Personal Tax burden increased when NICs taken into account?

The real increase in personal allowances and tax thresholds will reduce income tax as a percentage of income at all levels of incomes. If pressed the percentage paid in income tax plus NIC will rise for most people. But it will fall for the lowest paid (below $\frac{1}{2}$ average earnings (married) and below about $\frac{1}{3}$ average earnings (single)). Those over pension age who are taxpayers will benefit from the income tax changes and will be unaffected by the NIC rise, and, of course, National Insurance retirement pensions are also being uprated.

My Rt Hon Friend the Chancellor explained fully the effect of tax and National Insurance Contribution changes in answer to the Hon Member for Edinburgh, Central on 11 March (OA Col. 955).

3. No improvement in incentives?

There will be 1.2 million fewer taxpayers than if allowances had remained at 1981-82 levels, and $\frac{1}{2}$ million fewer higher rate taxpayers. For the substantial number taken out of tax or with reduced marginal rates, incentives will improve.

4. Failed to compensate for last year's non-indexation?

Impossible to finance - without grave risks to interest rates and present recovery - the additional £3 billion cost.

5. Income tax cuts only help highest paid?

Not true : those who will gain most are lowest as well as highest paid; i.e. gives greatest proportionate benefit to highest and lowest paid taxpayers who did worst in last year's budget.

6. No help on poverty trap?

Numbers in Poverty Trap should not be exaggerated. The increases in income tax allowances have a beneficial impact. [If pressed: overall there is a small increase in numbers in the poverty trap (10,000) as a result of the FIS uprating. FIS uprating helps low paid and generally makes employment more attractive than unemployment.]

7. Reduction in NIS not enough?

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

8. Excise duties increases inflationary/harmful to industries

Increases in excise duties as a whole slightly less than broadly compensate for past year's inflation. Variations between duties take account of industrial considerations including supplementary increase last July on tobacco/Scotch whisky industry/need to shield industry as a whole by smaller increase on derv and no increase on fuel oil.

9. Petrol/derv/VED increases anti-motorist/industry

These three duties not singled out; increases as a whole no more than broadly compensate for past year's inflation. 2p smaller increase on derv further shields industry and distribution costs by increasing 10p a gallon differential with petrol introduced last July.

10. Changes in basis of VED on lorries unexpected/add to costs?

Restructuring of VED on lorries proposed from October will allow distribution between lorry-types of unchanged overall burden to better reflect relative

shares of road track costs. Endorsed by Armitage Committee and forshadowed by 1981 Transport Act. Detailed rates in Finance Bill.

11. Reduce VAT?

Reduction in 15% standard rate not appropriate. Nearly half consumer expenditure zero-rated or exempt (including necessities like most food, housing, domestic heating). Applies equally to home-production and imports. Assistance provided for whole of UK private sector through reduction in NIS.

12. Why no VAT relief for charities?

Not possible: high revenue cost; serious definitional and administrative difficulties; would have repercussions in other areas, which could seriously erode VAT revenue base.

13. Not enough to encourage (existing) small firms?

Measures in the enterprise package substantial - full year cost of about £80 million. Moreover, third successive Budget to contain such measures. Many of the latest measures (for example, increase in "small companies" Corporation Tax profits limits, VAT registration thresholds, purchase of own shares) benefit existing small businesses.

14. Government take from North Sea Oil too high?

No. Slight reduction in the Government take is justified to preserve the North Sea as an attractive investment : a greater reduction would have tipped the balance too far in the industry's favour and reduced Government take below an acceptable level

E PUBLIC EXPENDITURE AND FINANCE

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

1. Public expenditure too high?

Spending in 1982-83 planned to be about £5 billion (4½ per cent) lower than intended by last Government even if higher than planned when this Government first took office. Decisions to increase spending represent flexible but prudent response to changed circumstances. Additional spending, for example, to help the young unemployed. Drive for more efficient management in the public sector and reduced administrative expenses continues.

[Ratio to GDP: see Q16]

2. Increase spending in recession?

Not Government's intention to try to spend its way out of recession. Any benefits would be very short-term, and would soon lead to more inflation and higher interest rates and inflation. But we are responding, within limits of prudence, to needs of current circumstances.

3. Real terms comparisons

No volume equivalents of cash plans. But cash increase in plans between years is 9 per cent in 1982-83, 5 per cent in 1983-84 and 6 per cent in 1984-85 (and projection of GDP deflator in MTF5 is rather lower than this in 1982-83, rather higher in 1983-84 and about the same in 1984-85). So in cost terms [ie cash inflated/deflated by the general movement in prices] there is an increase in 1982-83, a decrease in 1983-84 and a small decrease in 1984-85.

4. Plans unrealistic, given eg overspending in 1981-82/future rates of inflation?

Total spending in 1981-82 was expected to be only a little [NOT FOR USE: 0.4 per cent] higher than planned a year ago. Major reason for overspending is present level of spending by local authorities and this has been taken into account in plans. Realism, particularly in respect of local authorities and nationalised industries, is one reason why plans for future years are higher than in previous White Paper. Planning totals for 1983-84 and 1984-85 include Contingency Reserves of £4 billion and £6 billion. These are large to allow for the greater uncertainty about later years and are designed to give realistic planning totals in a cash regime.

5. Inflation assumption - higher in FSBR than in PEWP?

	Per cent		
	1982-83	1983-84	1984-85
[1981 Survey/PEWP cash factors	pay 4 non-pay 9	6	5
1982 MTFs: GDP deflator	8	7	6]

Yes but:

- (a) coverage by GDP deflator does not equate to movement of public sector costs (eg pay forms a greater percentage of costs in public service than in economy as a whole);
- (b) cash factors for Survey were not forecasts but provision which Ministers chose to make for general pay and price movements in public sector when starting 1981 Survey; decisions then taken on cash provision to make for each programme;
- (c) in due course, will consider adequacy of cash provision on programmes. This is to take into account a number of factors, including estimates of likely course of inflation. But other factors also important (eg individual needs of programmes, proportion of programme spent on pay, savings from greater efficiency). In meantime, uncertainties due to, eg, inflation are one reason for the large contingency reserves in later years; makes for realistic planning totals.

6. NIS reduction: effect on public expenditure?

[Programmes will be reduced to reflect reduction in NIS paid by public sector. First estimates of effect (included in post-Budget revised planning totals) is some £360 million in 1982-83 and £450-500 million in later years. Central government cash limits, nationalised industries' EFLs, and RSG will be reduced by full amount of reduction. Supply Estimates will be adjusted in due course.]

Government's intention in reducing the NIS is to help private industry, not public sector. Effect of clawback on public sector will leave its position broadly unchanged.

7. Not enough capital expenditure?

Government prepared to give priority to worthwhile capital projects wherever this can be done within overall spending totals. To increase the totals would be beneficial only in the short-term. Plans do allow for changed ⁵ between 1981-82 and 1982-83: as follows:

- public sector spending on new construction increase by 14 per cent;

- nationalised industries investment to rise by 26 per cent;
- increase in housing investment output (especially following Chancellor's announcement about housing improvement grants). [NOTE: if LAs take full advantage of receipts from sales, gross new investment can be as high as £3 billion next year];
- slight increase in work done on water and sewerage projects even though provision reduced).

8. Cuts in capital

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

9. Three million unemployed indefinitely?

See C4.

10. Cash planning means concentration on first year, not enough on services in later years (Plowden being abandoned)?

Government recognises case for medium-term planning. But planning must be in relation to availability of finance as well as in relation to prospective real resources. Illusion to suppose there can be an unconditional commitment to forward plans for services. Volume plans formerly had to be cut frequently because no allowance made for financial constraints - eg after IMF intervention in 1976.

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

Government last year concluded that provision for 1982-83 should be made on basis of a 4 per cent pay factor overall. This remains its view. Some public servants may get more than 4 per cent, some may get less. But no automatic entitlement. Every settlement will have to be justified on rigorous assessment of its merits. That position is unchanged. (See also J9-12)

12. Preferential treatment for Civil Service?

Mechanisms for dealing with expenditure on public service pay apply to the Civil Service as they do to others. An offer has been made to the non-industrial civil servants (grades up to

Principal) which averages 4.05 per cent. The unions have asked to go to arbitration and we have agreed in accordance with our undertaking to the Civil Service unions last year that if agreement could not be reached in this year's negotiations we would be prepared to go arbitration. The award will be subject if necessary, to override-with the approval of this House. (See also J 13-14)

13. Contingency reserve and pay

Existence of Contingency Reserve does not mean that excessive public service pay settlements will be financed. (If a pay increase is justified and cannot be financed within cash limits or by savings elsewhere, access to Reserve is possible. A decision Ministers would have to take at the appropriate time, bearing in mind other potential calls on the reserve.) Government's view remains that 4 per cent is a reasonable overall provision within its expenditure planning.

[NOTE: one third of cost of increased pay offer to nurses and certain other NHS staff will be met by health authorities. The remainder, less offset from NIS clawback, will be met from Contingency Reserve.]

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

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

15. Cut staff numbers in public services?

Numbers in public service have already fallen since we took office. Civil Service has been reduced by nearly 8 per cent to 675,400. This is smallest for nearly 15 years. We are well on target to achieve our aim of having 102,000 fewer staff in post in April 1984 than when Government came into office; this will be smallest Civil Service since the war. Local authority manpower has been reduced by nearly 75,000 (over 4 per cent). But manpower reductions are key to achieving long-term savings, and bigger reductions required to achieve Government's targets for LA current expenditure.

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

Ratios in 1980-81 (43½ per cent) and 1981-82 (45 per cent forecast) remain below the level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 mainly reflects

higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years: assumptions in MTFS would mean figures of 44½ per cent in 1982-83, 42½ per cent in 1983-84 and 41 per cent in 1984-85. Reflects assumed GDP growth and curbing of public expenditure.

LOCAL GOVERNMENT

17. Spending plans for 1982-83? Too tough? Too weak?

In order to set local authorities reasonable and realistic targets, we have increased the plans by £1.35 billion. But substantial economies will still be required as plans only allow about 2 per cent more cash spending than latest budgets for this year. [IF NEEDED: Future years' plans allow less cash growth, to get expenditure back on track.]

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

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

19. Effect of NIS reduction on local authorities?

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

20. Control of rates paid by industry

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

21. Green Paper on Domestic Rating System: rules out change?

No, it reaffirms our long-standing commitment to reform which we want as quickly as circumstances allow. The issues are complex and highly important to domestic ratepayers. The Green Paper sets out the requirements of any alternative source of revenue and describes the advantages and disadvantages of the alternatives in order to present the best basis for consultation.

F SOCIAL SECURITY

1. November 1982 uprating?

[Chancellor in Budget statement announced that most benefits are to be uprated by 11 per cent next November - 9 per cent for price protection and 2 per cent to restore shortfall. Secretary of State for Social Services gave details in his statement on 10 March.]

We have provided that all benefits usually uprated will maintain their purchasing power and will have restored the shortfall of 2 per cent which occurred at the last uprating. This includes those benefits where we have given no pledge of full price protection. The uprating of benefits next November will cost £1 billion in 1982-83 and nearly £3 billion in a full year. We could not afford to do more.

2. Why not restore November 1980 5 per cent abatement now that unemployment benefit is to be brought into tax?

Decision to abate UB was not simply taken as a proxy for tax but to reduce public expenditure and to improve incentives to find and keep work. (Chancellor's Budget statement in March 1980 made that perfectly clear.) Those reasons remain valid. Earnings are not at present moving ahead faster than prices. Rates of benefit already announced constitute a guarantee of protection against forecast movement of prices over the two years to November 1982. Any improvement on that would seriously worsen incentives. Cost too would be high - £60 million in a full year [net of reduced claims for supplementary benefit, but gross of tax.]

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

The benefits will retain their value in real terms. Claimants of supplementary benefit receive not only their scale rate entitlement but a cash payment to cover their housing costs in full. The recent large increases in housing costs have tended to make increases in the RPI higher than they otherwise would have been; supplementary benefit rates have accordingly been higher and there has been some double provision for claimants. The change corrects that. The abatement of $\frac{1}{2}$ per cent represents a broadly based adjustment for the likely relative movement of housing costs to November 1982. [NOTE: we do not want to make public a forecast of the housing index].

4. Increase in capital disregard should have been greater?

[Secretary of State announced a increase in capital disregard for supplementary benefit from £2,000 to £2,500.]

Change represents a 25 per cent increase in level of disregard since it was set in November 1980; this more than restores its value. No reason to suppose that the operation of the disregard causes any general hardship or that it has led to people deliberately disposing of capital in order to qualify.

5. Child Benefit increase too low?

[Child Benefit is to be increased by 60p, to £5.85 next November.]

That uprating will maintain the real value of the benefit since November 1980. It is not as high in real terms as the level set in April 1979, but the increase then is generally recognised to have been out of line - a pre-election move by the last Labour Government.

6. Earnings Limit

Earnings limit for pensioners has been increased from £52.00 to £57.00. It remains our intention to abolish the limit entirely. But so far we have not been able to do so, it has been essential to give priority to maintaining the purchasing power of benefits.

7. Death grant - increase to realistic level?

[Secretary of State for Social Services announced his intention to publish a consultative document on the death grant some time in week beginning 15 March.]

I know my Rt Hon Friend Secretary of State for Social Services would welcome comments on his consultative document on death grant which [EITHER: has just been published] [OR: is to be published later this week]. As we have always made clear, our aim is to redistribute the resources now devoted to death grant in a more sensible fashion - we cannot afford to add to those resources.

G PUBLIC SECTOR BORROWING

1. PSBR in 1981-82 and 1982-83

1982-83 PSBR published 9 March shows an estimated 1981-82 PSBR outturn of £10½ billion, and a forecast 1982-83 PSBR of £9½ billion.

PSBR in 1981-82 in line with 1981 Budget forecast and PSBR reduction in 1982-83 broadly in line with 1981 MTFS.

2. Effect of Civil Service dispute on PSBR?

PSBR in both years affected by Civil Service dispute. In 1981-82 some £½ billion of receipts delayed from March 1981 were collected but some £1 billion of receipts due in 1981-82 will now be collected in 1982-83. Debt interest cost of the strike some £½ billion in 1981-82.

3. CGBR April-Feb press notice implies odd CGBR for March?

CGBR April-February £8.1 billion - PSBR estimates 1981/82 £8.75 billion. The borrowing figures in the red book are consistent with the outturn information available so far this year.

4. PSBR should be higher/lower?

The PSBR reduction in 1982-83 is broadly in line with 1981 MTFS. IF PRESSED: the 1982-83 PSBR is really much higher than £9½ billion. The delayed tax receipts of £1 billion, the sales of extra assets of £½ billion, etc. imply a 'true' PSBR figure nearer £11 billion.

5. Others have used Treasury model to show larger PSBR would be beneficial

Using Treasury model does not endow such claims with respectability. Results depend on judgements and assumptions rather than pressing buttons. Often key factors such as interest rates and exchange rates are assumed fixed at some "desired" level. Interest rates cannot simply just be lowered at will. Effects on confidence very real and important but difficult to allow for. Reported analyses often are very short term.

H MONETARY AND FINANCIAL POLICY

1. Lower interest rates ?

[Bank base rates reduced by $\frac{1}{2}$ per cent to 13 per cent with effect from 12 March . Have come down by 3 per cent from peak of 16 per cent last autumn. Market rates generally have been falling .]

Of course we want to see lower rates . But we must proceed cautiously if we are not to let up in the fight against inflation. Despite difficult conditions abroad, interest rates have fallen.

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

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

3. Recent fall in interest rates incompatible with strategy

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

4. MTFS being quietly shelved?

[3rd MTFS states Government's objectives "to reduce inflation and to create conditions for sustainable growth in output and employment", by "steady but not excessive downward pressure on monetary conditions". Key financial indicators are the monetary aggregates and exchange rate. Target range for growth of M1, £M3, PSL2 in 1982-83 of 8-12 per cent. Illustrative path of 7-11, 6-10 per cent in 1983-84, 1984-85. Targets for later years to be set nearer the time.]

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

5 Monetary targets discredited?

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

6 Increase in target ranges

Ranges in past MTFS were purely illustrative. Did not take account of structural changes. Right to take account of current rate of growth in setting new targets, to avoid unduly sharp brake on monetary growth. 8-12 per cent still implies deceleration from current growth rate i.e. continued downward pressure on monetary growth.

7 What if aggregates' rate of growth diverge?

Will examine factors underlying divergence. Policy decisions will continue to take account of all available evidence with a view to restraining inflationary pressures.

8 Overshoot of 1981-82 £M3 target

∟ Preliminary information suggests £M3 was little changed during banking February; rate of growth over past 12 months (i.e. the target period) was 14.4 per cent. M1 fell by about $\frac{1}{2}$ per cent in banking February; grew by 8.7 per cent over past 12 months; PSL2 rose by about $\frac{1}{2}$ per cent in banking February; grew by 12.1 per cent over past 12 months. ∟

Growth in £M3 was above top end of target range, even allowing for effects of Civil Service strike. At least part of excess reflects increasing market share of banks in housing and consumer lending. Also reflects longer term effects of institutional changes such as ending of corset, abolition of exchange controls and changes in savings behaviour. These factors imply higher monetary growth permissible for same increase in nominal incomes.

9 Monetary conditions too tight?

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

10 Bank lending

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

11 Why more indexed gilts?

[Bank announced new index-linked gilt available to all investors on Budget Day. Restrictions on eligibility to hold existing indexed gilts removed.]

Issue of indexed gilts demonstrates Government's confidence in strategy of reducing inflation. Will allow direct access to indexation benefit to individual investors.

12 Giving money away by derestricting existing stock?

No: price rises not a cost to Exchequer. Over time, broadening of market should benefit Exchequer through reducing yields on new derestricted stocks.

J PRICES AND EARNINGS

1. When will single figure inflation be achieved?

[Year-on year rate of inflation unchanged in January at 12 per cent, compared with 21.9 per cent in May 1980 and lowest recent level of 10.9 per cent in July 1981.]

Budget forecast is for year-on-year rate of inflation of 9 per cent by Q4 1982, falling to 7½ per cent by mid-1983.

2. Inflation still higher than when Government took office?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 14.7 per cent.]

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

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

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

4. Effect of 1982 Budget on RPI?

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

5. Effect of 1982 Budget on TPI?

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

6. Nationalised industry prices

Nationalised industry price rises have been due in part to the ending of the previous Government's policy of artificial and distortionary price restraint. Rate of nationalised industry price rises is now coming more closely into line with the RPI. [See P12]

7. Current level of pay settlements?

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

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

[CBI figures published 17 February suggest that manufacturing settlements monitored since 1 August are averaging around 7 per cent.]

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

9. Public sector pay

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

10. The 4 per cent pay factor

The 4 per cent factor announced on 15 September [for calculations in Public Expenditure Survey] is not a pay norm. It is a broad measure of what the Government thinks reasonable and can be afforded as a general allowance for increases in pay, at this stage of fixing the programme from which the public service wage bill has to be met.

11. 4 per cent cash factor unrealistic/unfair?

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

12. Nurses broken through the 4 per cent?

The 4 per cent pay factor is not a norm. Government recognises need for pay settlements to take account of market factors, including effect on recruitment and retention of expensively trained staff in NHS. [See also E13 on public expenditure implications.]

13. Application to the Civil Service?

After two negotiating meetings with the non-industrial civil service trade unions no agreement reached. Unions have asked to go to arbitration. Government have agreed, in

accordance with undertaking given last July. Case will be heard (by Civil Service Arbitration Tribunal) in April.

14. Government offer to civil service reasonable?

In framing its offer the Government has placed much more emphasis on market considerations and management objectives than on comparability and the cost of living. The unions' emphasis is on the latter two aspects.

15. Average earnings index

[Fall in year on year growth from 11.3 per cent in November to 9.9 per cent in December may attract attention, though (unpublished) underlying increase, broadly unchanged at, just over 11 per cent]

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

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

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

17. Movement in TPI

Fact that has been increasing faster than TPI (roughly 3½ per cent faster over year to January 1982) reflects measures taken to restrain Government borrowing - essential in inflation is to be controlled.

18. Government aiming to cut living standards?

[Latest (revised) RPDI figures suggest no further fall between Q2 and Q3 1981.]

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

19. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, evasion, administrative cost, and interference with market

forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

20. Index-linked pensions and the Scott Report?

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

K BALANCE OF PAYMENTS

1. Balance of payments Q4 1981

[1981 Q4 figures for invisibles and capital transactions published 10 March]

Current account estimated to have been £1541 million in surplus in Q4, including a visible trade surplus of £623 million. Total 1981 current account surplus £8 billion.

2. Invisibles

Q4 invisibles surplus in Q4 1981 is put at £918 million compared with £400 million in Q3. This reflects EC receipts totalling £531 million, including budget refunds of £118 million. Increase in the invisibles surplus for 1981 as a whole largely due to 18 per cent increase in interest, profit and dividends surplus to £1148 million - demonstrating benefits of investing abroad.

3. Capital flows

Identified capital in flow in Q4 of £70 million. But the large 'balancing item' (£2100 million) means that all Q4 figures should be treated with caution.

4. Trends in exports

Non-oil exports were 3½ per cent higher in volume terms than in 1980. Exports of intermediate and capital finished manufactured goods are now higher in both value and volume terms than in 1979 and 1980 despite loss of competitiveness. DoI survey of engineering industry suggests export deliveries will continue to rise in 1982, as does CBI Industrial Trends Survey.

5. Trends in imports

December import figures are in line with the average for the previous 3 months. The recovery in imports is across the board, including basic materials and manufactures used by UK industry. This is consistent with view that destocking is coming to an end and the economy picking up.

L EXCHANGE RATE AND THE RESERVES

1. Sterling and the Budget

[Sterling was slightly weaker before the Budget in anticipation of a cut in UK interest rates, but recovered after the Speech, which was broadly in line with market expectations.]

As Chancellor again made clear in Budget, the exchange rate normally gives useful information on monetary conditions. While we have no target for the exchange rate, its effect on the economy and therefore its behaviour cannot be ignored.

2. Sterling still too high?

[Since last September, sterling has remained broadly stable and is currently over 12 per cent below its effective rate peak early last year. Recent lows have been \$1.77 on 14 September, DM4.07 on 20 October. Highs were \$1.97 on 30 November, DM4.407 on 9 February. Rates at close on 12 March were \$1.7986; DM4.274 and an effective rate of 90.07. Reserves at end February stood at \$23.4 billion, compared with \$23.2 billion at end January.]

The effective exchange rate is only slightly higher than when the Government took office. Manipulating the rate is no answer to problems in the real economy.

3. Has the Bank intervened to support the rate?

The Bank intervene to smooth excessive fluctuations and preserve orderly markets. They do not seek to maintain any particular rate.

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

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

5. Sterling should join the EMS?

[See M8-9]

6. Exchange rate and competitiveness?

I welcome the improvement in UK cost competitiveness of over 10 per cent in 1981. This has been partly due to a decline in the exchange rate; more importantly because there are signs that our domestic unit labour costs are now growing more slowly than those of our major competitors.

7. Debt repayments

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

M EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. 'Mandate negotiations'

On 25 January, Foreign Ministers had a lengthy discussion on the four key issues in the negotiations over the Mandate. It was not possible to reach agreement. The main issue preventing agreement was the view of a number of other Member States that refunds to the UK should be arbitrarily and automatically reduced over time, regardless of the scale of the problem. That was quite unacceptable to the UK. There was also disagreement about the duration of the new refunds arrangement. Foreign Ministers will consider these problems again at their meeting in March, on the basis of proposals from the Presidents of the Council and Commission.

2. Net UK contribution to community too high?

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

3. Lower Commission estimates of net contributions in respect of 1980 and 1981?

The most recent Commission estimates suggest that our net contributions in respect of 1980 and 1981 will be significantly lower than expected at the time of the 30 May Agreement. That is very satisfactory. For we remain one of the less prosperous Member States. The problem of 1982 and later years remains to be solved.

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

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

5. Do supplementary measures grants lead to additionality?

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

6. Policy for CAP reform

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

7. Costs of CAP to UK consumers

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

EUROPEAN MONETARY SYSTEM

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

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

9. When will the conditions be right?

Sterling is an international financial currency and is also particularly affected by oil market factors. These mark sterling out from other Community currencies, and add to the difficulty of the decision on the timing of sterling's participation. The balance of advantages, risks and disadvantages is constantly changing, so that the question of participation remains complex.

N INDUSTRY

1. Budget does not do enough for industry?

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

2. Industry's response to Budget?

[Sir Raymond Pennock, CBI President - "welcome fillip" to business confidence. Sir Terence Beckett, Director General CBI - 'moves in the right direction'. ABCC - 'insufficient and misconceived'. Saturday 13 March Financial Times Marplan survey of industry's reaction reports 77 per cent thought it 'fairly good' for the economy and half those polled thought would reduce inflation.]

Have noted the Association of British Chambers of Commerce's adverse comments, but pleased with the generally favourable response from industry, including CBI.

3. Prospects for industry-recovery?

Fall in output has now come to an end. Industrial production in Q4 1981 $\frac{1}{2}$ per cent up on Q3 and some 2 per cent up on H1. Budget forecast suggests there may be 3 per cent increase in manufacturing output in 1982 as a whole.

4. Company sector finances improved?

[Gross Trading Profits of industrial and commercial companies (ICCs) other than North Sea activities net of stock appreciation were around £4.3 billion in Q3 1981. Borrowing requirement of ICCs has improved over year to Q3 1981, and financial deficit turned into surplus. DOI's latest survey of company liquidity (published 4 December) shows further marked improvement in third quarter (particularly in manufacturing) bringing liquidity ratio back to 1979 Q3 level. NB figures difficult to interpret, however, particularly because of uncertain impact of CS dispute].

Figures mildly encouraging. Company financial position is in any case confused by effects of civil service dispute. After adjustment for stock appreciation and excluding North Sea, ICC profits have stabilised since mid-1980. Improvement in financial position partly reflects destocking and action to reduce overmanning.

5. Rate of return still too low?

[Real pre-tax rate of return of non-North Sea ICCs rose marginally to $2\frac{1}{2}$ per cent in 1981 Q3 compared to $2\frac{1}{4}$ per cent in Q2 (a record low)].

Yes, but Government can only help in limited ways such as reducing burden of NIS and creating the climate for lower interest rates. Further improvements in ICC's profits and

real rates of return can be expected, provided recent productivity gains and trend towards moderate settlements continue.

6. High interest rates damaging for industry and investment?

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

Budget measures should ease pressure on interest rates. But Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Continuing relatively high level of interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFs. (See brief H).

SMALL FIRMS

7. Government help for small firms

Budget provided further help for small businesses in addition to 75 measures taken previously. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under loan guarantee scheme this year (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

8. Response to Loan Guarantee Scheme?

Scheme operating successfully. We have already issued more than 2,700 guarantees - well over half to new businesses. Total lending under scheme is just under £100 million. Ten new banks were admitted to the Scheme in November 1981: a total of twenty-seven financial institutions are now participating. Budget provided for the lending ceiling - in year to May 1982 - to be raised from £100 million to £150 million. A further £150 million will be made available in following year.

ENTERPRISE ZONES

9. Progress with setting up Enterprise Zones?

Excellent progress being made. Ten of the eleven zones are already in operation. We expect the final zone - Isle of Dogs - to come into operation early in April 1982.

10. Response from private sector?

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

P NATIONALISED INDUSTRIES

EXTERNAL FINANCING LIMITS

1. EFLs for 1982-83 and future years?

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

2. Unreasonable to reduce EFLs following NIS cut?

Reduction in the National Insurance Surcharge was designed to benefit private sector; not the intention that public sector should gain from it. Reduction in EFLs will simply offset the addition to the industries' internal resources following the NIS cut. No industries will be worse off than previously, and their plans should be unchanged.

3. Pay assumptions?

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

4. External financing outturn for 1981-82 way over original limits?

During 1981-82, give industries had their external financing limits increased by a total of £0.5 billion, met from the Contingency Reserve, not an increase in expenditure. In granting these increases, Government recognised problems faced by some industries in a period of recession, and that, in some circumstances, EFLs could not be immutable. Not yet possible to make full assessment of ASLEF strike, but three industries in particular -National Coal Board, British Steel Corporation and British Rail itself - have been adversely affected in short term.

INVESTMENT

5. Investment plans for future years?

Overall, industries' investment plans on a rising trend. [CAUTION: Not true for each individual industry.] Increase in total planned expenditure on fixed assets since last White Paper is £200 million in 1982-83, £600 million in 1983-84 and £700 million in 1984-85, ie. an

increase of £1.5 billion over the three years. This implies total investment of no less than £24 billion over the three years. 1982-83 plans allow for 26 per cent more investment than in 1981-82, and 40 per cent more than in 1980-81. The industries will be financing a relatively high proportion - roughly two-thirds - of their fixed asset spending from their own internally generated funds, compared with the private sector where industrial and commercial companies finance four-fifths of their investment.

6. 1981-82 investment plans not fulfilled? Planned increase in 1982-83 investment simply 1981-82's plans deferred? Shortfall bound to recur?

[Latest estimate of shortfall published in FSBR is £750 million].

Shortfall this year disappointing, although latest estimates still suggest increase in real terms over 1980-81. Some reductions caused by need to live within EFLs. But at least as great a factor has been downward revision of investment plans by the industries in face of falling consumer demand. [IF PRESSED: We do not expect this to be as large a factor in 1982-83. But no Government can unconditionally guarantee a given level of nationalised industry investment for future, and it would be irresponsible to plough ahead with investment regardless of demand. The approved levels set out in the White Paper are consistent with the industries' increased external financing requirements, agreed for the industries.]

7. Take nationalised industry investment out of PSBR?

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

8. Private finance for NI investment?

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

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

9. Finance for British Telecom?

Work has been taking place on proposals for BT to raise capital on the market by issuing a new type of bond on which the return to the investor would be based on the profits earned by

the Corporation. Further work will now go ahead on preparing a prospectus. Government will want to satisfy itself, in light of market conditions nearer the time, that the bond represents good value to Government and BT, as well as the investor, but, subject to that condition, aim will be to go ahead with an initial sale in autumn 1982 in an amount to be decided, probably £100-£150 million. This will be an important experiment in exposing the performance of a nationalised industry to the judgement of the market place. But above all it remains our purpose to transfer to the private sector assets which can be better managed there.

10. Does the Government propose to sell shares in BT?

[Front page FT Monday 15 March.]

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

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

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

NATIONALISED INDUSTRY PAY AND PRICES

12. Nationalised industries' prices

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

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

13. Action in Budget to help industrial energy users?

Total benefit to industry estimated at £150 million in 1982-83 from measures in Budget (combined effect this Budget and last is £250 million over two years 1981-83), namely freeze on industrial gas prices from 1 April to end-1982; new tariff arrangements for largest electricity users (and continuation of arrangements on electricity prices announced last year); standstill till next winter on list prices for foundry coke; extension for 1 year of boiler conversion grants scheme.

PRIVATISATION

13. What further sales expected?

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

14. Net figure for special asset sales this year?

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

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

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

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

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

The British Gas Corporation is complying with the Government's direction to sell its interest in Wytch Farm. It is too early to say when the sale will take place.

17. Special disposals programme just a subsidy for speculators?

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

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

R NORTH SEA AND UK ECONOMY

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

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

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

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

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

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

[PM warned in 23 February speech that limited room for manoeuvre in Budget.]

Other things being equal, lower oil prices will reduce Government revenues from the North Sea. Treasury has estimated that each \$1 off the price directly reduces revenue, other things being equal, by £250 million in first year and £350 million in full year. But falling world oil prices are good for the world economy. We will benefit from that - not only from impact on activity, but also lower oil prices will help in reducing inflation. Latest revenue projections already incorporate fall to \$31 a barrel for Forties oil.

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

[FSBR projections (in money of the day) of Government revenues from North Sea: £6.4 billion in 1981-82, £6.2 billion in 1982-83, £6.1 billion in 1983-84, and £8.06 billion in 1984-85. Lower than last year's projections, principally because of downward revision to oil price expectations. Contribution of North Sea to GNP estimated at 3½ per cent of GNP in 1981. Projected to rise to about 4½ per cent by 1985.]

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

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

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

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

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

S WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

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

[Unadjusted unemployment exceeded 10 million in USA and 1 million in Canada in January. It exceeded 2 million in Italy in September, 2 million in France in October, and 1.9 million in Germany in February. Highest ever unemployment levels in Canada, France, Italy and UK and highest in USA and Germany since 1935.]

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

2. Anti-inflation policies not working?

[Year on year consumer price inflation in major countries fell to 9.4 per cent in December. Underlying rates falling in US. OECD and IMF expect some decline in 1982.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980 to around 8.9 per cent in January: some decline expected 1982.

3. Governments' policies have failed or worsened situation?

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

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

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

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

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

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

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

UK far from alone. Almost all European governments working to curb public spending, budget deficits and monetary growth. German government plans to reduce its borrowing in 1982 Budget even in nominal terms by almost 30 per cent. Unlikely investment/employment scheme will entail any significant increase in borrowing - increase in VAT (by 1 per cent to 14 per cent) part of the package from 1 July next year. Impact on employment remains to be seen.

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

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

8. Prospects for US economy?

[Report in FT Monday 15 March.]

Things are looking a little brighter in the US both on output score and, with lower interest rates, an improving outlook for inflation. And on the industrial relations front, there have been some encouraging settlements in which unions have clearly accepted lower wage increases in exchange for improved job security. [CAUTION: Not too much should be made of this: some upturn in US economy in the spring was expected.]

9. Even US using fiscal deficit to stimulate economy?

True US deficit is larger than anticipated. It is planned to fall but present level carries risk of prolonging period of high interest rates which could delay a European recovery. We strongly support the determination of the US authorities to combat inflation. But we believe fiscal and monetary policies must work together to that goal.

10. Recent international interest rate developments?

True that US interest rates rose earlier this year. But prime rates are well below their peak of 21½ per cent last summer and have fallen in the last few weeks. [Prime rates are currently 16-16½ per cent.]

11. Prospects for international interest rates?

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

PRESENT SITUATION

Most recent major outside forecasts (NIESR, P&D, CBI, LBS, St James) assess fall in output ended in H1 1981, with some recovery thereafter (in range 1-1½ per cent for 1982). ITEM and OECD are more pessimistic; seeing further falls of output into 1982. Year-on-year inflation is forecast by most groups to fall further to a range of 9-10½ per cent in 1982 Q4. Most groups see little possibility of further substantial reductions in 1983; inflation forecast to remain around 10 per cent in 1983. The March FSBR forecast, of a 1 per cent rise in output in 1982, and 10 per cent inflation in Q4 1982 is broadly in line with this consensus for 1982. FSBR sees 2 per cent rise in output in year to 1H 1983; 7½ per cent inflation by Q2 1983. Unemployment (UK adult seasonally adjusted) forecast to reach around 3 million by end 1982, with some groups (P&D, LBS, Simon & Coates) expecting stabilisation in 1982, others expecting some further rise.

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

Consumers' expenditure rose 1½ per cent in Q4 1981: the overall level in 1981 was only very slightly higher than 1980. Retail sales were virtually unchanged in the 3 months to February 1982. The volume of visible exports in Q4 1981 was at a higher level than at any time since early 1980. The volume of visible imports in Q4 1981 was back to the level of the first half of 1980 and 21 per cent higher than Q1 1981. DI investment intentions survey conducted in October/November suggests volume of investment, by manufacturing, distributive and service industries (excluding shipping) will rise by about 2 per cent in 1982 following a fall of about 5 per cent in 1981. A large rise is tentatively expected in 1983. Investment by manufacturing (including leasing) is expected to rise during 1982, but for the year as a whole it is likely to be 1 per cent lower than 1981. An appreciable rise is expected in 1983. Manufacturers', wholesalers' and retail stocks dropped by £20 million (at 1975 prices) in Q4 1981 the smallest quarterly fall in the two years of continuous destocking.

Unemployment (UK, seasonally adjusted excl, school-leavers) was 2,836,000 (11.7 per cent) at February count, up 7,000 on January. Vacancies were 113,500 in February.

Wholesale input prices (fuel and materials) rose ½ per cent in February; however the year-on-year increase fell to 12 per cent. Wholesale output prices rose ¼ per cent in February and are 10½ per cent above a year ago. Year-on-year RPI increase remained at 12.0 per cent in January. Year-on-year increase in average earnings was 9.9 per cent in December. RPDI was flat in Q3 1981 following falls in the previous two quarters and a 17.5 per cent rise over the 3 years 1977 to 1980. The savings ratio rose 1 per cent to 14½ per cent in Q3 1981.

PSBR £9.7 bn in the first three quarters of 1981/82 and CGBR (unadjusted) £8.1 bn in eleven months to February 1982; but both distorted upwards by the civil service dispute. Underlying PSBR for '81/82 believed in line with 1981 Budget forecast (£10½ bn).

Sterling M3 was little changed in banking February.

Visible trade showed a surplus of £0.6 bn in Q4 1981. Current account surplus of £1.5 bn in Q4 1981; likely surplus in 1981 as a whole of £8 bn. Reserves at end-February rose to \$23.4 bn. At the close on 12 March the sterling exchange rate was \$1.7995: the effective rate was 90.1.