

PPS/CHANCELLOR

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PS/Chancellor of the Duchy of Lancaster
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and officials in HMT, Revenue Departments
and other Departments in Whitehall

TREASURY WEEKLY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 19 July, are sidelined. During the coming Parliamentary Recess, this Brief will be circulated approximately once a month instead of once a week. The next will therefore appear towards the end of August.

M M Deyes

M M DEYES

RA

R I G ALLEN

26 July 1982

EB Division
H M Treasury
01-233-3364

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A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

[Longer term economic policy objectives discussed by Chancellor in CPC lecture 3 July, and interview published FT 5 July.]

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

2. Fiscal boost desirable?

[CBI campaign ^{for} boost in autumn; media speculation about some Ministers favouring this].

Well aware that CBI are pressing for lower interest rates, lower National Insurance Surcharge., lower business rates for industry and £1 billion package of capital spending by 1984. However, as Chancellor of the Exchequer has made clear, we intend to continue with our present economic policies since these offer the only sure way to economic recovery. Understand a meeting between Chancellor and CBI is being arranged.

In view of present favourable monetary developments and fiscal policy on course for 1982-83, no reason to change Budget judgement at this stage. (See also D8, E8, J4, P6 on specific CBI points).

3. Economy still in recession?

Recession can be defined in different ways. What is quite clear is that a turning point was reached in first half of last year, and that a modest recovery has begun - and is projected to continue. Most encouraging pointer to sustained recovery is progress against inflation (12-monthly RPI increase down to 9.2 per cent in June.)

4. Government policies caused recession by deflating demand?

[Industrial production down 11 per cent; GDP (output) down 5 per cent; total final expenditure down 1 per cent since first half 1979.]

No. Output had fallen much more strongly than demand during the current recession. At same time import penetration has continued on rising trend. Essential problems of economy lie on 'supply side' - lack of competitiveness etc. Government policies aimed at helping industry to redress these problems by : deregulating, restoring incentives and implementing a financial strategy under which inflation and interest rates can fall over the medium term.

5. Economic recovery in doubt?

[GDP figures for Q1 1982 show little change on Q4 1981. Latest industrial production figures show production in March-May 3 per cent higher than underlying spring 1981 level.]

May industrial production figures the most encouraging for some time - though too much weight should not be put on single month's information. Prospect is for continuing though gradual recovery: increase in May index could be first tentative sign of this. (See also Section B).

6. What factors caused recent flattening out in recovery?

Recovery is slow and fragile. Number of factors - temporary rise in interest rates last summer/autumn; temporary pause in progress on reducing inflation; slower, and later than expected, world recovery - could all have weakened confidence and activity. But prospect is for continuing through gradual recovery.

7. Tighter than expected fiscal policy to blame?

[Latest published estimate of 1981-82 PSBR £8.8 billion compared with Budget time estimate of £10.6 billion. PSBR 1982-83 June quarter, seasonally adjusted, £1.6 billion.]

Fiscal policy stance 1982-83, so far as can be judged at this stage, consistent with Budget judgement. Firm control of Government borrowing essential to maintain downward pressure on interest rates; latter have fallen four percentage points since last autumn and this can only improve prospects for recovery. (See also Section H).

8. Implications of developments in the US?

Welcome Mr Volcker's remarks last week stressing need for greater fiscal tightness while reaffirm^{ing} resolution to stick to monetary growth path around present target range for rest of 1982. Recent downwards movement in US rates and indications of slight pick-up in US economy also encouraging.

9. Recent interest rate/monetary developments?

For much of year UK interest rates falling in face of high US rates. Recent fall in latter should further improve prospects for ours. Steady reduction in UK rates made possible by satisfactory developments in main monetary indicators - monetary aggregates, exchange rate, and progress on inflation. Government borrowing also under control. Latest bank lending figures in May more encouraging but not yet sufficient to confirm improved trend.

10. Record unemployment levels?

[July figures show rise in UK (not seasonally adjusted) level to ^{3.19}~~3.06~~ million; seasonally adjusted figure 2.93 million.]

See Section C.

11. Report on Budgetary Reform by the TCSC ("Armstrong" Report)

[Report published 17 June.]

Government considering its recommendations. We did draw attention in our evidence to the various practical and other constraints and also to the progress already made in the Armstrong direction under this Government (eg MTFS). Thinking carefully about recommendations to publish Green Book/PEWP in January etc. But cannot anticipate reply to the report.

(i) Activity. Recovery has begun: industrial and manufacturing output 2-3 per cent higher than spring 1981. [But NB, underlying level of output broadly flat for last 6 months.] Business opinion surveys, most recent major independent forecasts, and CSO's cyclical indicators see prospect of continuing, but gradual recovery.

(ii) Investment. Total fixed investment rose 4 per cent between 4Q 1981 and 1Q 1982. DOI investment intentions survey suggests 2 per cent rise in and services' investment in 1982. Suggests fall in investment all but over. Private sector investment, particularly in plant and machinery holding up well. Investment in plant and machinery in 1981 only slightly (1½ per cent) lower than 1980, 8 per cent higher than in 1H 1979.

(iii) Total housing starts up 37 per cent in five months to May 1982 on 1981 average.

(iv) Interest rates. Short-term rates have fallen 4 points since turn of year (now about 12 per cent). Process temporarily interrupted by Falklands dispute, now resumed. Recent falls reflect several factors:- single figure inflation, M1, £M3 and PSL2 developing favourably in relation to target, Government borrowing under control, exchange rate firm.

(v) Inflation. 12-monthly increase in RPI now in single figures - 9.2 per cent in June - more than halved since spring 1980 peak (21.9 per cent). Inflation in June lowest since December 1978, but trend now firmly downwards, not upwards as then. Manufacturers' output prices up just 8¼ per cent in year to June.

(vi) Costs.

- Increase in average earnings halved in 1980-81 pay round. Public sector pay in line. Further moderation in average level of settlements in current round. CBI pay databank for manufacturing settlements suggests average now around 7 per cent compared with 9 per cent in previous round.
- Little increase in manufacturers' unit wage and salary costs over last year - only 3 per cent up in year to 1Q 1982, below average of our major competitors and comparable to that of Germany and Japan.
- Manufacturers' input prices up just 5½ per cent in year to June.
- CBI April survey shows lowest degree of unit cost pressures for 15 years.

(vii) Manufacturing productivity. Output per head rose 12 per cent since end 1980. Output per head and output per hour 5 and 8 per cent higher than previous peak in 1H 1979.

(viii) Competitiveness. Cost competitiveness improved by 10-15 per cent during 1981 reflecting pay moderation, higher productivity and exchange rate fall, but remains $\frac{1}{3}$ worse than in 1975.

(ix) Profits: Industrial and commercial companies gross trading profits (net of stock appreciation excluding North Sea) risen since 1Q 1981. In 1Q 1982 40 per cent higher than a year earlier. Recovery in profits from very low base: ICC's pre tax real rate of return just $2\frac{1}{2}$ per cent in 1981.

(x) Exports have held up better than many feared following 50 per cent loss of competitiveness between 1975 and 1Q 1981. In 9 months to May 1982 non-oil exports (excluding erratics) slightly (about 1 per cent) higher than in 1980.

(xi) Special employment measures. Total provision for special employment schemes planned to reach £1½ billion in 1982-83, and to be £4 billion over current and next two financial years. 280,000 unemployed school-leavers last year found places on YOP by Christmas.

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

(xiii) Overseas debt repayments. Official external debt reduced from over \$22 billion in May 1979 to around \$13.7 billion at end-May 1982.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Recent output figures

[Underlying level of output broadly unchanged in six months to March. In part reflects impact of very severe weather and industrial disputes at turn of year. Latest figures show industrial (excluding North Sea) and manufacturing production rose some 1 and 1½ per cent respectively between April and May. But in latest three months underlying level of industrial production little changed from last autumn, 3 per cent higher than in spring of last year.]

Whilst recent output figures have been disappointing, prospect remains of continuing but gradual recovery. This view shared by CSO (index of leading indicators) and most outside forecasts (see 5-6 below). Whilst not too much should be made of one month's figures, May index of industrial production could be first tentative sign of this. Best help for sustained recovery is lower inflation and interest rates.

2. Other evidence of improvement in economy?

See Bull Points (following Section A).

3. Fall in CSO's shorter leading indicators suggests further hesitation in economy?

CSO index of shorter leading indicators based only on partial information. Care needed in interpretation month to month movements in this index. Longer leading indicators, outside forecasts, etc suggest continued gradual recovery.

4. Government's forecasts?

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

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

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

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

5. FSBR forecast now looks too optimistic?

[Recent press reports (eg FT 29 June) suggest latest internal Bank and Treasury forecasts put growth in 1982 less than FSBR forecast of 1½ per cent; inflation lower than FSBR forecast of 9 per cent. Several independent forecasts have recently revised down their forecasts of growth in 1982 marginally (from around 1½ per cent to about 1-1¼ per cent), largely reflecting the recent disappointing output figures. Despite this most groups have not altered their assessment of the strength of the recovery during the course of 1982 and in 1983 (NB but several groups forecast 2-2½ per cent growth in 1983 on the basis of some fiscal stimulus - a further cut in NIS or reductions in the standard rate of tax - in the 1983 Budget).]

Recent output figures are disappointing (though May more encouraging), but we have been doing rather better than expected on inflation. Clearly there are uncertainties and dangers, not least of which will be the international environment - though there are some recent more favourable indications of the beginning of recovery in the US. At present there is no reason to doubt the broad shape of gradual recovery as forecast at Budget time. Certainly the majority of outside forecasters do not doubt it.

6. Outside forecasts

[GDP profile in recent major assessments:

	<u>NIESR</u>	<u>LBS</u>	<u>St James</u>	<u>Phillips & Drew</u>	<u>CEPG</u>	<u>CBI</u>	<u>OECD</u>	<u>FSBR</u>
	(May)	(June)	(Apr)	(July)	(April)	(May)	(July)	(March)
Per cent change 1982 on 1981	+1	+1	+1¼	+1½	-½	+1	+1¼	+1½]

Nearly all see prospect of continued recovery (as always, a range, with Cambridge forecast (CEPG) being the more pessimistic) and see single figure inflation through rest of 1982 - also in line with FSBR. [See also C3 (unemployment)].

7. Latest CBI assessment?

[CBI Enquiry for June reports little change in order books or stocks since last April, and expectations of broadly flat output over next four months. S. Brittan (FT 5 July) suggests 'preliminary evidence' of more pessimistic July CBI enquiry and lower CBI forecast of growth.]

CBI June Enquiry disappointing: confirms recent indications of temporary flattening out in activity since last autumn. But encouraging signs of further moderation in inflationary expectations - necessary condition for improved growth. Latest CBI forecast believes modest recovery will resume in second half of this year, and predicts inflation rate below 8 per cent this autumn. [Results of July Survey expected 3 August.]

C LABOUR MARKET

[NB. Debate on mass unemployment (Opposition motion) 27 July.]

1. Recent unemployment figures and other labour market indicators?

NB Employment figures (May) to be released 29 July]

[UK seasonally adjusted unemployment, excluding school leavers, was 2,926,000 (12.3 per cent) in July. Total number UK registered unemployed rose by 129,000 to 3,191,000 (13.4 per cent). Highest post-war level, surpassing 3,071,000 recorded in January. Rise reflects usual large influx of school leavers (304,000 in July, up 76,000 on June) plus further seasonal rise of 35,000 and an underlying increase of 16,000. UK seasonally adjusted vacancies increased by 6,000 in July to 111,000. Recent unemployment/vacancy figures shown below:

	1980 Q4	1981 Q1	Q2	Q3	Q4	1982 Q1	Q2	Latest 3 months
Unemployment (UK adult sa)	105	77	62	51	33*	21*	30*	25*
Vacancies level	99	98	89	96	104	112	107	108

*After allowing for over 60's transferring to supplementary benefit.

Other labour market indicators (overtime, short-time, hours worked in manufacturing) also suggest some flattening out in improvement observed last year.]

Government deeply regrets both high level of unemployment and sharp increase in 'headline' total. But rise in first seven months this year only one third that in first seven months of 1981; vacancies in July around one-fifth higher than in Q2 1981.

[IF PRESSED Apparent general weakening of labour market indicators can be interpreted as consistent with hesitation in recovery since last autumn. Cannot draw implications from July figures about future levels of unemployment.]

2. Unemployment higher than in other countries?

[On standardised definitions in Q4 1981 UK unemployment was 12½ per cent compared with 7½ per cent OECD rate; a UK doubling compared with an OECD rise of almost one half 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.

3. Unemployment expected to continue rising rapidly?

[Speculation recorded total may rise to around 3¼ million in August reflecting seasonal rise of about 45,000 along with likely increase from upward underlying trend. No significant fall in 'headline' total expected until October.]

Unemployment forecasts uncertain; independent forecasters encompass differing views for 1983 - several projecting stabilisation, some [a slight] decline. Rise in unemployment so far this year less than half that of a year ago. Employment situation will benefit from some

further recovery in activity this year (see B1). [IF PRESSED: Government has not sought to deny 3¼ million a likely figure this summer.]

4. What is Government's own forecast of unemployment?

[FT 23 July alleges Treasury sources expect 4 million will be reached.]

Government does not publish such a forecast. Quite wrong to extrapolate past unemployment increases when trend has been improving. However it was assumed for expenditure planning purposes in Cmnd 8494 that unemployment (GB, excluding school leavers) would average 2.9 million in 1982-83, and for rest of survey period. Current (July) figure is ^{2.82}~~3.01~~ million and, though this is still rising, it is not inconsistent with PEWP figure.

5. Employment continuing to fall?

[Total employment declined 2.1 million (9 per cent) between mid 1979 and end 1981.]

Decline in H2 1981 about two-thirds that in H1. Best help for permanent jobs is sustainable recovery.

6. Recent productivity gains inimical to higher employment/lower unemployment?

[Output per head in manufacturing up 12 per cent since end-1980.]

This may be true in the short run. But in the longer term, as experience in UK and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

7. Higher rather than lower wage increases needed to stimulate higher productivity

[Discussion of productivity by D Blake The Times 21 July].

Causation is wrong: higher productivity should precede higher wages. Small wage increases, taking into account productivity of workforce, the need to rebuild profits, and the performance of competitors, provide the best prospects for more productive sustainable jobs.

8. What is Government doing to provide more jobs?

Government pursuing sensible fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless Government expanding schemes to meet special difficulties and improve training - eg plan to spend £1½ billion in cash on 1982-83 (40 per cent more than in 1981-82) on special employment and training measures; new Youth Training Scheme costing £1 billion a year from 1983-84; and MSC working on proposed new community work scheme announced in Budget Speech.

9. MSC Task Group proposals on youth training?

Government has accepted Task Group's scheme as immense step towards setting standards and systems of training for young people as good as those anywhere overseas.

D TAXATION

1. Burden of taxation

[Total taxation (i.e including for example income tax, indirect taxes, corporation tax, rates and NIC) in 1978-79 was 34½ per cent of GDP (at market prices), 36 per cent in 1979-80, 37½ per cent 1980-81. It is forecast to be 40½ per cent in 1981-82 and 39½ per cent in 1982-83. Corresponding figures excluding NICs are: 1978-79 28½ per cent, 1979-80 30 per cent, 1980-81 31½ per cent, 1981-82 34 per cent, 1982-83 33 per cent.]

This has inevitably increased during a time when the recession has been adding to public spending. Changes proposed in Budget will reduce total burden in 1982-83 compared with 1981-82. [NB: Not true of burden on persons.]

2. Burden of tax has risen for most households/real weekly net income fallen since 1979?

[Parliamentary Written Answer 7 July col 111-2 showed that real weekly net income has fallen for manual workers.

Slow growth of output and difficulty of restraining public expenditure have inevitably meant higher tax burden. But aggregate real personal income after direct taxes still higher than under last Government [although not true of all sections of population]. And more honest to raise taxes to finance necessary higher expenditure than to increase borrowing, with the increased interest rates and inflation that would bring.

3. Burden has fallen for the rich?

Abolition of absurdly high marginal rates and raising of thresholds in 1979 essential to remove disincentives. Reimposition of an 83 per cent top rate of income tax would finance a reduction of less than one quarter of 1p in the basic rate.

4. Burden has risen most for the poor?

Proportion of income paid in income tax and NICs will fall in 1982-83 for lowest paid taxpayers. And low paid with children entitled to benefits such as FIS.

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

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

6. No improvement in incentives?

There will be 1.2 million fewer taxpayers in 1982-83 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.

7. Government action needed to help those in poverty/unemployment traps?

[CST appear once before TCSC Sub-Committee Wednesday 21 July].

CST emphasised that problem of traps was serious, and that best way of solving it was by raising tax thresholds - but this must depend on economic growth. He stressed need to control and reduce public spending.

8. Further cut in NIS?

[Called for by CBI].

Reduction due to come into operation on 2 August (equivalent one percentage point cut for whole of 1982-83) will benefit private sector by £640 million in 1982-83 - on top of decisions to shield employers from increases in National Insurance contribution rates over last 2 years. Acknowledge desirability of further reductions. But expensive. Right time to consider this is autumn.

9. Excise duties increases inflationary/harmful to industries

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

10. How has Government used fiscal incentives to encourage wider share-ownership?

Total of over 460 profit-sharing and share option schemes now approved by Inland Revenue. Compares with less than 30 in May 1979. Reflects liberalisation and extension of arrangements to promote profit-sharing and share-option schemes contained in 1980 Finance Act. Further fiscal encouragement on way from 1982 Finance Bill.

E PUBLIC EXPENDITURE AND FINANCE

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

1. Public expenditure too high?

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

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

Ratios in 1980-81 (43 per cent) and 1981-82 (44½ per cent forecast) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 mainly reflects higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years: assumptions in MTFs would mean figures of 44½ per cent in 1982-83, 42½ per cent in 1983-84 and 41 per cent in 1984-85. Reflects assumed GDP growth and curbing of public expenditure.

3. Ratio to GDP must grow unless big improvement in economic performance?

[David Blake article The Times 30 June on official study of long-term public expenditure.]

An official study prepared on long-term public expenditure as part of normal, and continuing, process of controlling public expenditure and monitoring longer term effects. Has yet to be considered by Government. But report may point too pessimistic picture of level of public expenditure in long term. Government's policies are designed to secure real and lasting improvement in our economic performance; evidence that they are succeeding. Inflation is already coming down faster than expected at budget time.

4. Study on longer term public expenditure concludes that unemployment could stay at 3 million for rest of decade?

This is not a conclusion of the study. Report does not make any forecast of future unemployment - it uses a purely hypothetical assumption, intended to show what might happen to public expenditure if the worst is assumed about unemployment.

5. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term. If increased spending not financed responsibly, would soon lead to more inflation. If financed

prudently, would lead to higher interest rates and/or higher taxes. We are responding, within limits of prudence, to needs of current circumstances.

6. Spending Ministers seeking extra £5,000 million public expenditure in 1983-84?/Treasury once again seeking cuts in public expenditure?

Bids for additional expenditure have been put forward in usual way as part of annual public expenditure survey. Ministers collectively will have to decide which are to be allowed and, depending on size of any increase, to what extent the increase should be met by savings elsewhere.

7. Not enough "productive" public investment/needs being jeopardised?

Government is not cutting "productive" investment. Partly question of definition - within figures for capital expenditure totals, council house sales count as a negative item and defence procurement counts as current expenditure. Furthermore, nationalised industries are financing an increasing proportion of investment out of own resources. Also since mid-1970's needs have been declined; future standards and public amenities will not be jeopardised.

8. More capital projects in public sector to help private industry?

[Current CBI campaign].

Government prepared to give priority to worthwhile capital projects within overall spending totals. However, no question of an artificial and inflationary stimulus to demand a new projects must be considered on their merits. Nationalised industries investment in 1982-83 planned to be about a quarter higher than in previous year. Real answer: to provide private sector with prospect of higher rates of return on investment by continuing policies to lower interest rates and increase incentives.

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

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

10. End-year flexibility?

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

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

Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on. Provision for public service pay increases 1982-83 limited 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 drive for more efficient management throughout public sector.

12. What allowance will Government make for pay increase in public services next year?

Government attaches great importance to realistic wage settlements next year, in both public and private sectors. Provision for public service pay will be made from within cash plans for 1983-84. (See also K8.)

13. Will Government's operation of cash limits for civil service [and NHS] pay change as result of Megaw Inquiry Report?

Government is committed to policy of using cash limits to control public expenditure. We will consider and discuss the implications of Megaw report in due course.

LOCAL GOVERNMENT

14. Overspending in 1982-83? Government response?

Local authorities are budgeting to spend some £1½ billion above Government's plans (£1¼ billion in England, £200 million in Scotland, £60 million in Wales). Government cannot ignore this large planned overspend. In ENGLAND, Environment Secretary intends to implement scheme for grant abatement announced last year and is considering further across-the-board grant cut. Secretary of State for SCOTLAND is seeking to reduce grants of Lothian Regional Council (by £45 million) and Stirling District Council (by £1½ million). Secretary of State for WALES has announced his intention to withhold grant. He also asked Welsh local authorities to submit revised budgets. Amount of grant to be withheld will be determined in light of these. Local authorities have only themselves to blame for these grant penalties.

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

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

16. Local government finance 1983-84?

Refer to announcement by Environment Secretary Tuesday 27 July.

17. Lower rates for industry?

See P4.

18. Government's plans imply enormous job losses?

Not necessarily. Government's plans for local authority expenditure are realistic and achievable. Local authorities could do a lot to help themselves by moderating pay and improving efficiency.

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

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

F CIVIL SERVICE STAFFING AND PAY**1. Civil Service too big/does too much/is over staffed?**

Since Government came to office, Civil Service has been reduced by 9 per cent to 666,400. This is smallest since 1966. Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve aim of having Civil Service of 630,000 by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Civil service pay: non-industrial civil servants

Civil Service Arbitration Tribunal awarded pay increases ranging from 4.75 per cent to 6.25 per cent - worth 5.9 per cent overall - and increases in annual leave. Government accepted award which is being implemented. Increases (announced 12 May) for higher civil service (under-secretary and above) were larger; they were decided in light of recommendations of Top Salaries Review Body. Cash limits and manpower targets not being adjusted. (See also Section K).

3. Megaw Inquiry

Report of Megaw Inquiry into arrangements for deciding civil service pay in future has now been published (Cmnd 8590). Report contains number of important recommendations which are now being considered. (See also E12-13 and K7-8.)

4. Civil Service pay: industrials

[Settlement date 1 July 1982]

On 23 July Government made offer to industrial civil servants estimated to cost about 6 per cent in pay year from 1 July 1982. Cost would be met from within existing cash provision.

5. Scott Report/Public sector pensions?

See K 16.

1. Restore abatement of Unemployment Benefit?

[Uprating in November 1980 was abated by 5 per cent; this foreshadowed in Budget Speech announcing plans to bring UB into tax.]

Abatement of unemployment benefit has been extensively discussed in House of Commons. We undertook to review when the benefit was brought into tax. We did not, however, commit ourselves to restoration of the abatement. We have undertaken the promised review, and have decided that we cannot afford to restore the abatement.

2. But abatement was a proxy for tax?

Always made clear when decision to abate was announced that it was not solely a proxy for tax but also part of a public expenditure savings package, and a measure likely to improve work incentives.

3. Cost of restoration substantially less than tax revenue?

[Cost of restoration £20 million first year, £60 million full year. Revenue from taxation now estimated at £650 million.]

Wrong in principle to hypothecate money from taxing benefits. But if MPs want to make such a comparison I would draw attention to cost of restoring shortfall in November 1981 uprating - £525 million in full year - this and other increases in social security expenditure more than accounts for the additional revenue.

4. Abatement hits at poorest section of the community?

Only one quarter of the unemployed are solely dependent on UB and hence affected by the abatement. All those affected will have been unemployed for no more than a year and are primarily single people or childless married couples.

5. Increase in PSBR from deficit on National Insurance Fund?

[Government Actuary's Report on Benefit upratings, published 29 June, showed substantially increased deficits on NI Fund for 1981-82 (up from £153 million to £1,045 million) and 1982-83 (up from £94 million to £350 million). These figures distorted by CS strike; underlying deficits nearer £600 million in 1981-82 and £800 million in 1982-83.]

For 1981-82, the published outturn already takes this into account. For 1982-83, revised deficit is one of a number of factors which will affect PSBR but is not, in itself, a sufficient reason to change our overall assessment of PSBR prospects.

6. Increase in National Insurance contributions because of NI Fund deficit?

The higher deficits for earlier years do not make inevitable an increase in contribution rates for 1983-84. A decision on the level of these rates will not be made until late Autumn and

will take account of forecasts made at that time of Fund income and expenditure for 1983-84.

7. Burden of State pension scheme too high?

[Government Actuary's Department Quinquennial Review of National Insurance Fund, published Wednesday 21 July, analyses possible future (up to forty years) cost of contributory benefits and levels of contributions needed to pay for them. Most important factor is increasing expenditure on earnings-related pension. Conclusions depend on assumptions about growth in earnings, prices, unemployment etc over period, but on certain assumptions contributions could change from present relationship to earnings - 16.5 per cent combined employees' and employers' contributions - to 15.4 per cent by 1985-86, but rise to 16.7 per cent by 2005-6 and 21.9 per cent by 2025-6.]

Government Actuary's conclusions not firm predictions but illustrations of possible future burden on certain assumptions. We shall be considering report carefully before reaching any conclusion. In meantime DHSS will be consulting widely with interested organisations and would welcome comments by end of this year.

8. Merger of income tax and national insurance planned?

Government's written evidence to TCSC did not suggest such a merger. Committee asked about feasibility of merging the two systems, and the evidence gave an illustration of what a joint system would look like.

9. Death grant - increase to realistic level?

[Consultative document about death grant published 3 March, comments asked for by 30 July.]

Social Services Secretary would still welcome comments on consultative document on death grant published in Spring. As that made clear, aim is to redistribute in more sensible fashion resources now devoted to death grant - cannot afford to add to those resources.

H FISCAL POLICY AND THE PSBR

1. Progress on Fiscal Policy?

[Aim is to achieve reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress; Government has succeeded in reducing PSBR as percentage of GDP, and further reduction is projected. Inflation is now lower than, and interest rates are as low as have been, at any time in last three years.

[IF PRESSED: Real interest rates still uncomfortably high here and overseas; serves to emphasise need to reduce borrowing over medium term.]

2. How does UK fiscal stance compare with other countries?

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. US experience shows that failure to bring fiscal and monetary policy into line can put excessive pressure on interest rates.

3. How much was PSBR undershoot in 1981-82 and why?

[PSBR for last year turned out £1.8 billion lower than estimate of £10½ billion given in 1982-83 FSBR.]

Information is still incomplete, but higher debt interest receipts, better receipts from Inland Revenue and lower 'supply' issues contributed to the undershoot. Some factors went the other way - deficit on National Insurance Fund for instance turned out higher than expected. The civil service dispute added considerably to uncertainties at time of Budget, and was main factor in most of the errors.

4. 1981-82 undershoot shows fiscal policy too tight?

Last year's undershoot probably does mean fiscal policy somewhat tighter than planned, but must examine strategy as a whole. Firm control of Government borrowing one factor responsible for fall in interest rates (four percentage points) since autumn.

5. Why treat PSBR as crucial statistic when prone to very substantial forecasting error?

[Margins of error are wide: plus or minus £4 billion.]

Although forecasting PSBR is hazardous, this in no way diminishes importance of achieving better balance between Government spending and income. Recognised by all Governments, whatever the difficulties of forecasting.

6. Isn't 1982-83 PSBR likely to undershoot too?

[Budget forecast for 1982-83 was £9.5 billion. PSBR for June quarter £2.8 billion (£1.6 billion seasonally adjusted) - broadly consistent with forecast for 1982-83 as a whole.]

Rash to jump to conclusions about this year's PSBR. PSBR turned out higher than expected in 1979-80 and 1980-81. Last year, many people expected this to be repeated in 1981-82. PSBR figures for April-June quarter consistent with Budget forecast.

[IF PRESSED: Some of reasons for undershoot last year may imply lower PSBR this year (eg higher tax receipts). But other factors (pressure on Contingency Reserve from Falkland spending, changes in estimated NI contributions) could go other way. Unwise therefore to conclude £9½ billion forecast for this year's PSBR particularly high. Risks in both directions.]

7. Implications of PSBR outturn in April-June for PSBR in 1982-83?

[PSBR for April-June inclusive (published 22 July) was £2.8 billion; April-June 1981 was £7.8 billion.]

Last year's figures severely distorted by Civil Service dispute so comparisons can be seriously misleading. PSBR in June quarter consistent with Budget forecast, so far as can be judged at this stage.

8. Seasonally adjusted, PSBR in April-June too low?

[PSBR, seasonally adjusted, for April-June inclusive was £1.6 billion. Do not fall into trap of multiplying this figure by 4 to get PSBR for 1982-83].

No. Quite wrong to multiply figure by 4 to get 'revised PSBR' estimate for 1982-83. Seasonal adjustment only removes effect of factors occurring at same time each year. Many irregular influences remain e.g tax receipts collected in June quarter delayed from effects of last year's civil service dispute.

9. If PSBR higher in 1982-83 than in 1981-82 won't interest rates have to rise?

As percentage of GDP, outturn for 1981-82 is more or less equal to the forecast for 1982-83 i.e around 3½ per cent. The 1982-83 forecast is still a low figure both by comparison with deficits abroad and in relation to size of deficits over past decade.

10. Implications of lower than planned public expenditure in 1981-82 for 1982-83?

Detailed public expenditure outturn information for 1981-82 will not be available until later this month. Until then, implications for 1982-83 uncertain. [IF PRESSED: It is estimated, on very incomplete information, that the planning total will fall from £105.2 billion in the PSBR to below £105 billion and that ratio of public expenditure to GDP will fall from 45 per cent to 44½ per cent].

11. Unadjusted PSBR misleading guide to fiscal action?

Cyclically-adjusted PSBR may have some merit as indicator but poor guide to fiscal policy. It is actual Government expenditure and revenue that determines the level of interest rates to be financed and influences level of aggregate demand.

12. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's].

Policy of this Government is to fight inflation, not to accommodate it. If 'inflation-adjusted PSBR' is in surplus, this calls for cut in inflation, not expansion of actual PSBR.

13. Parliamentary control over borrowing?

[EST at Select Committee on Procedure 29 June].

Welcome interest shown in Procedure Committee. Will continue to provide information to help Parliament reach view on what is happening. Open mind to consider any suggestions from Committee about form of information. [IF PRESSED: Propositions for some form of control a different matter: could complicate policy decisions on spending and revenue].

J MONETARY AND FINANCIAL POLICY

[N.B 26 July announcement about hire purchase requirements].

1. Monetary growth in 1981-82

[Figures for banking June (fourth month of target period) indicated that £M3, M1 and PSL2 grew by 2.0, 0.8 and 0.6 per cent respectively (seasonally adjusted). These changes bring annual rates of growth in 1982-83 target period to 9½, 6¼ and 9 per cent respectively, compared with target range of 8-12 per cent.]

Too early to judge outturn over target period as a whole, but recent figures are again encouraging. Figures point to continuing steady downward pressure on inflation.

2. Monetary conditions too tight?

Exchange rate, money GDP and monetary aggregates suggest financial conditions have been moderately restrictive whilst allowing falls in interest rates. Growth of bank lending is still strong, however; we do not believe that monetary conditions have been too restrictive.

3. Bank lending

Banking June figure is again lower indicating that growth may be slowing. But although part at least of recent growth is in substitution for building society lending and other forms of consumer credit, to the extent that it is additional it may add to inflationary pressures; so must continue to proceed cautiously on interest rates.

4. Interest rates still too high?

[CBI call for Government 'action']

Interest rates have come down significantly over past 6 months, and bank base rates have now fallen four percentage points since their peak last autumn. Of course we would like to see rates lower still; but we must proceed cautiously if we are not to jeopardise progress made to date in reducing inflation. Lower inflation offers best prospect for sustainable lower levels of interest rates.

5. Bank of England and Treasury in conflict, one wanting hold up exchange rate, the other to get interest rates down?

Bank's operations in the money market represent an agreed course of action.

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

US rates not sole determinant of UK rates, but high US rates certainly an adverse development and in September were a key factor in driving our rates up. Recently, however, sterling has remained reasonably firm, probably helped by improved prospects for

wage round, and good trade figures. UK interest rates have eased this year against US trend; but we cannot insulate ourselves from difficult international background. (See also T10.)

7. Outlook for mortgage rates?

Recent developments encouraging but cannot anticipate decisions of Building Societies Association

8. 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.

9. Why have you been 'over-funding' and providing large-scale money market assistance?

[Latest Bank of England Quarterly Bulletin carried small feature explaining process.]

The rapid growth of bank lending (much of which relates to structural changes) creates problems for conduct of monetary policy. By selling long-term Government debt on larger scale outside banking system it has been possible to contain growth of money which the lending would otherwise have produced. If we had not intervened to relieve resulting shortages in money markets, the banks would have been forced to bid for deposits, raising short-term interest rates to levels which, according to other indicators of monetary conditions, were not justified.

25 JUNE MONETARY PACKAGE

10. Will tax change on zeros and deep discounts reopen corporate bond market? Surely the tax treatment remains unfavourable?

Too soon to say how companies will respond. The tax treatment clearly is not as favourable as some would want - but to allow companies to offset discount against tax and investors to be taxed as on capital gains, would introduce unacceptable asymmetry. Announcement represents important step forward - and we have said we are looking at an accruals based system on US model. Best hope for revival of corporate bond market of course remains lower inflation and lower interest rates. We are on course for both.

11. Doesn't the amendment to the National Loans Act remove the only constraint on the Bank's purchases of bills? Will it mean even huger purchases in the future?

National Loans Act amendment is designed to remove essentially fortuitous constraint on Government's ability to borrow. Existing law could have prevented Government funding its

borrowing requirement. Does not necessarily mean large increases in bill purchases. Scale of money market assistance will depend on future course of bank lending etc. Other measures designed to ensure it does not grow so rapidly - encouragement of corporate bond market and variable rate lending to local authorities.

12. Doesn't high Government funding and money market assistance merely mean higher long rates and lower short rates? Isn't it this that prevents companies borrowing long?

Level of interest rates depends essentially on scale of Government borrowing rather than its form. We have succeeded in reducing PSBR and Government's call on financial markets; which has paved way for lower interest rates. Lower funding and higher short term finance would mean higher money supply, which would cause expectations of higher inflation and raise interest rates.

13. Government simply acquiescing in and accommodating rapid growth of bank lending?

Growth in bank lending is response to high inflation and structural changes following ending of direct controls - which were proven to have little effect. Tax and borrowing measures announced 25 June will have some impact on rate of growth but if impact of bank lending on money supply minimised no cause for alarm about inflationary prospects.

K PRICES AND EARNINGS

PRICES

1. Inflation lower than under previous Government?

[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 14.0 per cent.]

Year-on-year rate of inflation was 10.3 per cent and rising when previous Government left office in May 1979. Now (June ¹⁹⁸²) 9.2 per cent and falling. On present forecasts, we will be first Government for quarter of a century to successfully reduce the average rate of inflation during its term of office.

2. How low inflation by end 1982?

[Budget time forecast Q4 1981 to Q4 1982 9 per cent and Q2 1982 to Q2 1983 7½ per cent.]

No new forecast to offer at this stage, but the year-on-year rate of inflation was already 9.2 per cent in June. In the coming months, moderation in unit labour costs and competitive pressures on firms to limit price rises suggest Budget-time forecast of 9 per cent by this November could well be bettered.

3. Inflation still not as low as competitors?

[UK inflation 9.5 per cent in May, compared with 6.7 per cent in US, 5.3 per cent in West Germany, and 2.8 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

4. Long term inflation objective?

[Chancellor's speech in Cambridge 3 July]

Recent developments encouraging. But inflation rate still higher than some competitors e.g Germany. Must not let up. Have always made it clear that price stability not unattainable.

5. Movement in tax and prices index?

[Increase in TPI over 12 months to June 9.4 per cent, compared with RPI increase of 9.2 per cent].

Fact that TPI has been increasing faster than RPI reflects measures taken to restrain Government borrowing, which is essential if inflation is to be controlled. But following recent Budget, difference is now small.

6. Nationalised industry prices

[Increase over 12 months to June 14.0 per cent, compared with RPI increase of 9.2 per cent].

Gap between nationalised industry price increases and RPI due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 have also played important part. Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position has been improving steadily for past year or so, but sustained improvement only possible if industries succeed in holding down current costs, particularly pay. (See also R7.).

PAY

7. Zero pay norm in next round?

[Chancellor's Speech 6 July.]

This Government is not in the business of setting pay norms. Individual pay bargains need to take realistic account of the particular circumstances, and of the fact that the greater the restraint, the better prospect for jobs. No right to automatic pay increases every year.

8. Will there be a new pay factor for public expenditure?

Not yet been decided whether plans for next financial year will be calculated on basis of an explicit 'pay factor'. However, Government finances large proportion of country's pay bill; will have to ensure its own actions are compatible with overall needs of economy.

9. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. Certainly lower than in the past year.

10. What has been average over past year/pay round?

Average has been in single figures, and moving downwards, in each of past two years. We need a substantial further reduction, with really low settlements, and thus a better outlook for jobs, in the year ahead.

11. Government exhortations on pay imply aiming to cut living standards?

[Latest RPI figures published 1 July show Q1 level much same as in Qs 2 and 3 1981 (Q4 discounted as 'erratically low'), and lower than Q1 1981.]

Lower pay settlements have not in fact cut real earnings in either of the past two years; prices have also come down. This fact casts doubt on the wilder claims about the effect of pay moderation on living standards.

12. Incomes Policy

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

13. NHS pay

Social Services Secretary announced 23 June that a further £90 million should be made available for increased pay offer in Health Service. This would allow increase in average pay for nurses of 7½ per cent, ambulance men and hospital pharmacists 6½ per cent, and other staff 6 per cent. Government believes this provides sound basis for settlement.

14. Top Salaries Review Board increases too large?

[Government announced on 12 May increases of 14.3 per cent for senior civil servants and senior members of the Armed Forces, and 18.6 per cent for the judiciary.]

Government believes these increases are fully justified. Essential to ensure adequate supply of candidates of sufficient calibre for the Bench, and to provide adequate career structure and differentials in higher levels of Civil Service and Armed Forces. TSRB are only group whose present salaries are below those recommended for April 1980.

15. Average earnings index

[Year on year growth 10.3 per cent in May compared with 10.2 per cent in April. However, underlying unpublished increase slightly lower than in April at around 10 per cent.]

Encouraging that underlying rate of growth continues to fall. But must remember change over the 12 months to May straddles two pay rounds - not entirely indicative of recent trends. Also, earnings index inflated recently by some increase in hours worked.

16. Index-linked pensions and Scott report?

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

L BALANCE OF PAYMENTS

1. May trade figures?

[Figures published 9 July show May visible trade deficit of £15 million, estimated overall current account surplus of around £35 million. Cumulative current account surplus £0.9 billion so far this year. Exports fell by some £105 million, mainly due to a fall in oil exports and erratics. Imports rose by £205 million in May, due to higher imports of manufactured goods. Invisible surplus projected at £150 million a month].

Current account fell substantially during May, due to large fall in oil exports from April's high levels and £200 million increase in deficit on non-oil trade. Cumulative surplus this year approaching £1 billion.

2. Exports

Export volumes of manufactured goods now back at high level of 1981 Q4, and holding up well. Export volumes (excluding oil and erratics) in three months to May were 7 per cent higher than a year earlier.

3. Geographical analysis of exports?

Exports to OPEC and other developing countries have risen 10 per cent (3 months on 3 months). Exports to North America have been adversely affected by the US recession and have fallen 1 per cent (on same basis).

4. Imports

Imports of finished manufactures rose by £125 million, principally concentrated in capital and intermediate goods, reflecting a strengthening of investment activity. Imports of oil rose by some £35 million, accounting for some of the fall in the visible balance, while imports of basics, which also fell, remain 8 per cent higher than in 1981 Q1.

5. Worrying trend of import penetration?

Recent figures do suggest some underlying increase in import volumes. But in May, imports of cars fell slightly, and the imports increase was principally concentrated in capital and intermediate goods - suggesting a strengthening of investment activity in UK.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[Since last autumn sterling has remained broadly stable. The average £ effective rate in Q1 1982 was over 10 per cent lower than in Q1 1981. Previous lows were \$1.7470 on 6 April, DM 4.098 on 21 May. Highs were \$1.97 on 30 November, DM 4.407 on 9 February. Rates at noon on 23 July were \$1.7624, DM 4.2284 and an effective of 91.04. Reserves at end June stood at \$17.7 billion, compared with \$17.8 billion at end May.]

Government has no target for exchange rate. The rate is taken into account in interpreting domestic monetary conditions and taking decisions on policy. Despite recent sharp fluctuations in value of some currencies caused by strength of dollar, sterling's effective exchange rate has remained relatively stable.

2. Bank of England intervening to support the rate?

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

3. Concerted intervention to reduce value of dollar?

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

4. Improve UK competitiveness by devaluing exchange rate?

Experience shows that exchange rate cannot be manipulated by Government against underlying market trends. Any attempt to lower it by intervention or by relaxing monetary control leads to higher inflation. For example the effective exchange rate depreciated by over a quarter between 1972 and 1976 without leading to any improvement in UK competitiveness.

5. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to \$14 billion by end of 1981. This has been more than achieved - external debt is now around \$13 billion, compared with over \$22 billion when the Government took office.

7 Policy for CAP Reform

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

8. Costs of CAP to UK consumers

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

EUROPEAN MONETARY SYSTEM

9. 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.

10. Join the EMS for exchange rate stability?

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

EXPORT CREDITS 'CONSENSUS'

11. Progress on Export Credit Consensus negotiations

In October 1981 participants of OECD-sponsored 'Consensus' reached an interim agreement on the new terms to be applicable for export credits. These terms were to be effective until 15 May 1982. The chairman of the Consensus's second set of compromise proposals were discussed at an EC Council of Ministers on 30 June. Proposals included reclassification of some countries and increase in interest rates charged to 'rich' and 'intermediate' country borrowers. These proposals have now been agreed subject to one outstanding issue concerning the country classifications of Greece and Ireland.

P INDUSTRY

1. Prospects for industry-recovery?

[Recent figures of new company registrations up; but bankruptcies at record high levels]

See A5 and B1.

2. Companies' financial position?

[Industrial and commercial companies (ICC's) - excluding North Sea - gross trading profits (net of stock appreciation) rose 40 per cent to Q1 1982. But rise was from very low base - ICC's real rate of return just 2½ per cent in 1981. ICC's finances showed some weakening in Q4, reflecting slowdown in destocking, and unwinding of civil service dispute, but finances better in 1981 as a whole -

	1979	1980	1981			£bn
			Year	H1	H2	1982
						Q1
Net borrowing requirement (+)/repayments (-)	+6.1	+5.7	+4.4	-1.2	+5.6	+3.5
Financial surplus (+)/deficit (-)	-2.7	- 1½	+1.2	+1.5	-0.3	-0.5

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

3. Rate of return still too low?

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

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

4. CBI call for action and meeting with Chancellor

See A 2 .

5. High interest rates damaging for industry and investment?

[CBI estimate that each 1 per cent reduction in interest rates reduces industry's borrowing by around £250 million.]

Budget measures have eased pressure on interest rates, and the recent ½ per cent fall in the banks' base rates is encouraging. But Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get

rate of inflation down so as to create a stable environment for business decision-taking. Continuing relatively high level of interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFS.

6. Lower rates for industry?

[Part of CBI current campaign].

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even that would cost approximately £140 million per annum. Legislation would be required.

7. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken so far to over ninety. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme (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?

[Nearly 5,000 guarantees already issued - about half to new businesses. Total lending under scheme just under £167 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. After first year, of nearly 5000 guarantees issued, only 50 have been 'called'. Cost has been more than covered by the premium income received over the period. Scheme is kept under continuous review. (Report on sample survey of borrowers placed in Library of House by Parliamentary Under Secretary of State for Industry (Mr MacGregor) on 12 July).

9. Enterprise zones: response from private sector?
first

All/eleven zones now in operation. 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.

Chancellor announced Tuesday 27 July ten new Enterprise Zones to be created : 7 in England , one each in Scotland, Wales and Northern Ireland.

R NATIONALISED INDUSTRIES

EXTERNAL FINANCING LIMITS

1. EFLs for 1982-83 and future years?

Nationalised industries' total external finance increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes). Increase in 1982-83 was roughly half what the industries bid for. Government has given full recognition to problems faced by the industries in a period of recession. EFL's for 1983-84 will be announced later this year, as usual.

INVESTMENT

2. Investment plans unlikely to be attained?

No Government can unconditionally guarantee a level of investment by the nationalised industries. Approved levels set out in last White Paper (Cmnd 8494) are consistent with the industries' agreed external financing requirements, on the basis of their internal resource forecasts. But perfectly possible that plans might need to be revised, for example if the industries fail to restrain their current costs, including pay.

3. 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.

4. Is PM satisfied with the rate of return on capital in the nationalised industries?

[Pre-tax rate of return on nationalised industries' capital (including subsidies) has recently been announced as being minus 1 per cent (about the same as in 1979). This compares with 3 per cent for industrial and commercial companies.]

No. That is why we are continuing to press for greater efficiency within nationalised industries, and are setting realistic financial targets to ensure that the taxpayer and consumer get proper value for money.

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

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

6. Private finance for NI investment?

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

NATIONALISED INDUSTRY PAY AND PRICES

7. Nationalised Industries' prices

[Having risen approximately in line with retail prices for several months, the latest figures show bigger 12 months increase in nationalised industry, water and London Transport than all items RPI (13.8 per cent in June compared 9.2 per cent). This differential reflects March increase in LT fares and ending of electricity industry's rebates to consumers. Removal of these temporary distortions confirms that nationalised industry prices are still increasing somewhat faster than RPI, largely because of increases in energy sector.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position has been improving steadily for past year or so. The differential between RPI and NI prices water charges and London Transport fares is now 4½ per cent compared with 14 per cent in January 1982. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

8. What is Government doing to improve Nationalised Industries' efficiency?

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. A rolling programme of Monopolies and Mergers Commission investigations has been set up. The introduction of market zones provides greatest incentive to efficiency.

PRIVATISATION

9. What further sales expected?

Special sales of assets in 1982-83 forecast at around £700 million and around £600 million in each of the later years. These figures well above those in last White Paper. This reflects primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - to be made possible by Oil and Gas (Enterprise) Act (which received Royal Assent in June). Industry Secretary announced 19 July plans to sell 51 per cent of British Telecom - but not before next Election.

10. Special asset sales in 1981-82

Gross sales in 1981-82 totalled £481 million, so target published in 1981 Public Expenditure White Paper of £500 million nearly met. Pleasing result - included two large sales - Cable and Wireless (£182 million) and Amersham International (£64 million). True that delivery of BNO oil in 1981-82 paid for in 1980-81 and taken into account in special disposals figure for that year reduced 1981-82 receipts by £573 million to total of -£92 million. But it is gross figure which is true measure of success of Government's privatisation programme. As Chancellor said in Cambridge 3 July, 'Public utilities and the so-called "natural monopolies" cannot be allowed permanently and without challenge to remain within State ownership'.

11. Government has sold assets too cheap?

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

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

12. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham); preference in allocation of shares (B Ae, C & W, Amersham, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company.

S NORTH SEA AND UK ECONOMY

1. Onerous tax system damaging future field developments?

[Shell/ESSO announcement plans for Tern shelved partly because of tax system; Press reports that Phillips are postponing T-block complex and BP their Andrew field].

Other adverse factors - falling oil prices earlier this year; high development costs - much more important. Detailed study showed that under new tax structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that new structure will provide more secure and stable tax regime.

2. Chancellor's oil taxation package announced 9 June

[Summary: No field to pay APRT for more than 5 years; APRT repaid after 5 years if not set off against PRT; APRT allowed as a deduction in computing payback; further proposals to smooth PRT payments in second half of 1983; cost £55 million 1982-84]

Following Budget proposals, industry expressed concern on a number of specific matters; we have decided that some mitigation of burden for less profitable, more marginal fields is appropriate to meet particular problems. Tax system introduced in Budget, plus these changes, should enable nation to get its fair share from profits of this national asset, while leaving plenty of incentive to continue developing it.

3. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Bill Clause 129) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

4. Government should do more to promote UK Continental Shelf oil production in 1990's?

[Select Committee on Energy's Report on depletion policy published 18 May: recommends reserve powers to impose production cuts but main emphasis on promoting development of fields to come into production in 1990s - increase pace of licensing rounds and overhaul fiscal regime].

Government's considered reply will be given in due course. Accept need to prolong high levels of UKCS production until end of century at least. Energy Secretary announced 17 May Government's plans for Eighth Round of licensing. Do not accept that fiscal regime makes North Sea development unattractive. On Committee's general proposal for overhaul of regime, would point out that industry does not want a structural upheaval: it would create serious uncertainty and major transitional problems.

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

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

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

6. North Sea revenues should be channelled into special fund?

North Sea revenues are already committed. Setting up special Fund would make no difference. More money would not magically become available. So 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.

7. Is Government underestimating North Sea revenues?

No. Other estimates of Government revenues based on assumptions that seem over-optimistic eg on future production.

8. Future North Sea oil prices?

A matter for commercial negotiation between oil companies and BNOC.

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

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

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Why don't major industrial countries together lead revival of Western economy?

OECD's Economic Outlook explains clearly why. Western Governments are convinced 'a significant part of any stimulus to demand would increase public sector deficits, and dissipate itself rather quickly as an increase in inflation'. Furthermore, there is 'the possibility of re-igniting inflationary expectations, which became firmly established over a decade or more...' Remarkable unity on this at recent Finance Ministers' meetings and at Versailles Summit.

2. Western Governments' policies will increase unemployment to 32 million?

[OECD Economic Outlook published 7 July forecast unemployment 'approaching 32 million' in first half 1983 or 9 per cent of OECD Labour force (10½ per cent of Europe's.) Also notes that unemployment is concentrated on the young, and that, in Europe, about one third of jobless have been unemployed 6 months and more.]

True that OECD forecasts rising unemployment - largely as result of increase in number of people looking for work. But OECD also forecasts employment to rise by over 2 million people in OECD area next year.

3. OECD says global recovery won't last?

[Economic Outlook warned investment so far shows little sign of pick-up needed for recovery to be self-sustaining. But same paragraph ends by emphasising importance of improving business outlook.]

Lower inflation should help reduce interest rates and coupling of these two with recovery in output will generate right climate for recovery in investment during 1983.

4. French government 'seen the light' over reflationary policies?

[French government announced package of austerity measures including 4 month prices and wages freeze (to reduce inflation to single figures), increases in social security and unemployment contributions and limit to budget deficit of 3 per cent of GNP in 1982]

Strength and stability of Western economies as a whole will benefit if France - and Italy - can control inflation. So we welcome French government's recognition that inflation is as serious a threat as unemployment and that reining in public sector borrowing is essential part of counter-inflation strategy.

5. Comparison of French Socialist Government 1981-82 with Labour Government in 1974-76?

Many similarities. After oil price shock both governments gave fight against inflation low priority and sought immediate economic growth. In both cases unemployment rose strongly - in UK's case it doubled - inflation and rates of increase in earnings rose, current

accounts ran substantial deficits and currencies were depreciated. Important differences, though: French economy fundamentally more healthy, French labour force less unionised, France committed to EMS, but no prospective North Sea oil to help out current account.

6. French unemployment risen despite Socialist growth policy?

[French unemployment 10.8 per cent of labour force in June 82; risen by 1.6 per cent of labour force since May 81 - same as the rise in the average rate for all 7 major industrial countries over same period. (N.B UK's rate has risen more)].

Yes. Unemployment has risen strongly in all industrial countries save Japan. France no exception. But rate of increase in unemployment has not yet slowed down - unlike UK.

7. Anti-inflation policies are working

[Inflation down from a year ago in 5 of major 7 economies - significantly down in US (from 10 to 7 per cent), Japan (5 to 2½), Italy (20 to 15) and UK (11 to 9). Small reductions in Canada (to 11½), Germany flat, but increase in France (from 13 to 14).]

Yes. Firm fiscal and monetary responses to 1979-80 vindicated by events. UK still some way to go to match US, Germany or Japan in bringing down inflation, but moving in right direction and ahead of some other European countries. Realism in wage settlements is growing; US, Germany and Japan all have wage settlements in single figures. Other policies also working: oil savings have helped cut OECD oil demand. All point towards basis for sustainable recovery.

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

No. OECD's forecast for UK is close to most recent domestic forecasts and predicts average growth of about 1½ per cent in 1982, rising to annual rate of 2 per cent in second half of 1982. That is very closely in line with OECD forecast for whole of Europe. Unemployment is expected to rise in all major countries except Japan. UK inflation still forecast to exceed OECD average in 1982 because of recent falls in inflation rates of USA, Germany and Japan, but UK should average OECD rate next year. Could do it this year if more responsibility in wage settlements.

9. Better prospects for US economy?

[Q2 GNP figure showed growth of 1.7 per cent at annual rate. But estimates of severity of decline in Q4 and Q1 increased and industrial production still falling in June (10 per cent below July 81). Seasonally adjusted unemployment is 9½ per cent (10½ million), and bankruptcies at post-war high. Inflation and manufacturing earnings both rising at 6½-7 per cent. Tax cuts, effective 1 July, expected to boost consumers' expenditure in Q3].

Yes. Welcome possible indications worst of US recession may be over. Federal Reserve Chairman Volcker noted in testimony to Congress recently that most important trend in US economy was long-term downward shift in nominal wage settlements, which, in

manufacturing, are now around $6\frac{1}{2}$ per cent. If combined with productivity improvements this could lead to very low inflation rates in US.

10. US Budget?

[Congress agreed on budget deficit of \$104 billion, deficits greater than \$116 billion. Congress's decision legally binding; outline agreement has now to be translated into detailed budget by Congressional committees.]

Hope Congress will soon reach agreement on details of budget for FY 83, as uncertainty about budget is probably an important factor adding to pressure on US interest rates.

11. US interest rate developments

[Prime rates dropped $\frac{1}{2}$ per cent in mid-July to 16 per cent; other interest rates fell. Chairman Volcker told Congress that Fed would allow some M1 growth above top of target range and would not act to reduce temporary bulges.]

US interest rates fell recently. Volcker testimony to Congress should reassure markets of broad counter-inflationary thrust of Federal monetary policy. Agreement on details of budget would improve prospects for lower interest rates.

12. 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.

U FALKLANDS CRISIS EFFECTS/COSTS

1. UK economy affected by Falklands crisis?

Possible economic consequences cannot of course be ignored. But UK is basically in a strong financial position: inflation is coming down; interest rates on downward trend; balance of payments remains healthy; output is higher than a year ago. Disturbance due to Falklands dispute small in relation to overall macro-economic picture. No question of requiring any change in basic economic strategy.

2. Will dispute with Argentina affect UK trade figures?

Volume of UK-Argentine trade negligible (£20 million a month on either side).

3. Effect of financial restrictions on Argentina?

The crisis restrictions reduced Argentina's capacity to raise loans on the international markets, and will continue to do so while the freeze on assets remains.

4. Future of restrictions?

European Community (and certain other countries) ended their measures on 20 June. USA and New Zealand ended theirs when we accepted de facto end of hostilities (12 July). But arms embargoes remain. UK's measures remain in place for the time being.

5. Argentina's debts

[NOT FOR USE: Argentine foreign debt at end 1981 estimated at \$34 billion - about half size of Mexico's or Brazil's.]

Argentina may be seeking debt relief in talks with certain creditors about debt rescheduling. Not with British banks while freeze on assets continues. Proper rescheduling agreement would need to involve all creditors. [IF PRESSED on debt default possibility: banks have taken fairly relaxed attitude because ultimately overseas debt must be repaid by exports; Argentina's export sector is agriculture, which, according to most experts, is fundamentally healthy.]

6. Falklands defence costs?

[Specific figures for replacement of equipment, requisitioning merchant ships etc on BBC programme 8 July were speculative.]

Preliminary assessment of broad order of defence costs (excluding garrison costs) is about £550 million in 1982-83, and £200 million in each of the following two years. Non-defence costs (compensation, rehabilitation) are expected to be minor in comparison. Totals should represent only a very small proportion of total public expenditure.

7. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these costs will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). Necessary financial provision is being made available. Not yet clear how existing FCO and ODA funds will be adequate and how far additional sums will be needed.

8. Is Government paying compensation for war damage?

Government has made it clear that compensation will be generous. [PM's reply at Question Time 15 June Hansard col 739.] Officials working on practical details. No estimate of the cost can yet be made.

9. How will the various costs be met?

Intention is to try to absorb 1982-83 costs within the Contingency Reserve - and to some extent within existing budgets. Remains to be seen how far feasible. How future years' expenditure is to be funded will depend on decisions in forthcoming Public Expenditure Survey. Extra costs to defence budget (costs of the operation eg fuel ship chartering, and equipment replacement) will be met out of monies additional to the 3 per cent annual rate of real growth already reflected in sums currently provided for defence. Decisions have yet to be taken on other programmes. In any case, the costs will be met in a way consistent with the Government's economic strategy.

RECENT DEVELOPMENTS AND INDICATORS

(i) Activity. GDP fell by 6 per cent between 1979 H2 (last cyclical peak) and 1981 Q2 (trough of current recession), rose about 1 per cent between 1981 Q2 and 1981 4Q then declined by $\frac{1}{4}$ per cent in 1982 Q1. Weakening at turn of year in part reflects impact of severe weather and strikes.

Underlying level of output broadly flat in 6 months to March 1982, but industrial and manufacturing production rose some 1 and $1\frac{1}{2}$ per cent respectively between April and May. Excluding North Sea industrial production in 3 months to May no higher than last autumn, but about 3 per cent higher than spring of last year. Most independent forecasts, business opinion surveys, and CSO's cyclical indicators expect resumed and continued recovery; May production figures could be first tentative signs of this.

Volume of new engineering and construction orders in 1981 up 14 and 12 per cent on 2H 1980. Whilst home orders in some areas have continued to improve in early 1982 export orders tended to weaken around the turn of the year. Private housing starts up over one third between 2H 1980 and 1981. Total housing starts in 5 months to May 1982 up 37 per cent on 1981 average.

Recovery in 1981 largely reflected sharp fall in rate of destocking. Consumers' expenditure and Government consumption broadly flat. Fixed investment broadly flat in 1981, up 4 per cent between 1981 Q4 and 1982 Q1; DOI investment intentions survey suggests rise of 2 per cent in MDS fixed investment in 1982.

(ii) Lack of complete trade figures for 1981 and changed documentation procedures make recent figures difficult to interpret. Exports have held up better than many had feared. In 9 months to May non-oil exports slightly (about 1 per cent) higher than in 1980. Non oil imports have risen - up 13 per cent in same period - in part reflecting reduced rate of destocking and further rise in import penetration ratio. Current account estimated to be in surplus of £1 billion in first five months of 1982 following £7 billion surplus in 1981.

(iii) Employment and unemployment. UK employment fell 2.1 million (9 per cent) between 2Q 1979 and 4Q 1981 (about two-thirds concentrated in manufacturing), though rate of decline has slowed down. UK adult unemployment risen by 1.6 million since 2Q 1979 (less than fall in employment) and stood at 2.93 million (12.3 per cent) in July. Total unemployment (including school leavers) was 3.19 million (13.4 per cent). Underlying rate of increase in unemployment was 105,000 per month in 4Q 1980, cf 22,000 per month in first seven months of 1982. Other labour market indicators improved during 1981; eg short-time working down by $\frac{1}{4}$ during 1981, overtime up by over 10 per cent during 1981, and vacancies - despite slight weakening since February - up by $\frac{1}{5}$ in 2Q 1982 on 2Q 1981, and

with more rapid turnover. Little or no further improvement in unemployment or other labour market indicators since turn of year.

(iv) Wages and prices. Increase in earnings in 1980-81 pay round 11 per cent (settlements averaged about 9 per cent), half that of previous pay round. Settlements well inside single figures are now widespread (CBI average for manufacturing 7 per cent) suggesting further moderation in current pay round. 12-monthly increase in RPI 9.2 per cent in June; well inside single figures. Recent progress suggests outturn to November this year could well be within Budget time forecast of 9 per cent. Manufacturers' input prices up just 5½ per cent in 12 months to June. Corresponding rise in manufacturers' output prices 8½ per cent.

(v) Productivity and Competitiveness (manufacturing). Output per man risen 12 per cent since end-1980. Output per man and output per man hour 5 and 8 per cent respectively higher than previous cyclical peak (1H 1979). Together with pay moderation, resulted in little increase in unit wage and salary costs during 1981 - rise of less than 3 per cent in year to 1Q 1982 - a rate below average of our competitors and comparable to Germany and Japan. Competitiveness (relative normalised unit labour costs) improved by 10-15 per cent during 1981, but remains about 1/3 worse than in 1975.

(vi) Company finances. Gross trading profits of ICCs (net of stock appreciation excluding North Sea) rose about 40 per cent in year to 1Q 1982. But real pre tax rate of return just 2½ per cent in 1981. Despite rise in company borrowing and deterioration in liquidity in 4Q 1982 (largely reflecting reduced sale of destocking and unwinding of civil service dispute which delayed companies' tax payments), company finances healthier in 1981 as a whole than in 1979 and 1980. Company liquidity improved in 1Q 1982.

(vii) Monetary aggregates. £M3 grew at an annual rate of 13 per cent in 1981-82 target period (from mid-February 1981 to mid-April 1982) compared with target range of 6-10 per cent. At least part of excess reflected increased market share of banks in mortgage lending. Over the same period, M1 and PSL2 grew at rates of 7 and 12 per cent per annum respectively. In recent months monetary aggregates have grown more slowly; in first 4 months of 1982-83 target period M1, £M3 and PSL2 grew by 6½, 9½ and 9½ per cent at annualised rates respectively of target range of 8-12 per cent.

(viii) Interest rate/exchange rates. Interest rates have fallen since turn of year; process temporarily interrupted by Falklands crisis, but now resumed. 3 month inter-bank rate has fallen from 16 per cent in December to about 12 per cent. After falling over 10 per cent during spring and summer 1981, effective exchange rate broadly constant at around 90 since last August.

(ix) Government borrowing. PSBR £8.8 billion in 1981-82 (3½ per cent of GDP, compared with 5 3/4 per cent in 1980-81) about £1½ billion lower than estimated at Budget time. In first quarter of 1982-83 PSBR was £1.6 billion.