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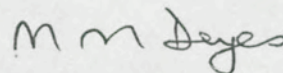
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 and officials in HMT, Revenue Departments
 and other Departments in Whitehall

TREASURY WEEKLY BRIEF

Attached is the latest version of this Brief. Changes from the previous Brief, of 6 June, are
 sidelined.



M M DEYES



R I G ALLEN

20 June 1983

EB Division
 H M Treasury
 01-233-5503

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A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

[Programme for new Parliament will be set out in Queen's Speech Wednesday, 22 June. Chancellor's speech in subsequent Debate on Address will constitute his first major statement on economic policy in Government's second term of office.]

Intend to consolidate and build on progress already made in creating conditions for healthy economy. Will maintain sound financial policies conducive to lower inflation and take further measures to promote enterprise and encourage competition.

2. What about employment?

As obstacles to more efficient working of economy are cleared away, new job opportunities will open up. But Government will continue to help ease process of adjustment with special employment measures and assistance for training. Important that people do not frustrate process by perpetuating inefficient practices or demanding pay increases that undermine improvement in competitiveness already made.

3. Current economic situation

Modest recovery is under way, not just in sectors like North Sea and house-building, but also in many parts of manufacturing. Major destocking has come to an end. Private investment recovering and retail sales remain buoyant. Other indicators - including recent CBI reports, and CSO cyclical indicators - point in direction of continued recovery. With inflation lower and evidence (eg from US and Germany) that world economy is picking up, good prospects that recovery will be sustained. (See also Section B.)

4. Economic achievements of 1979-83 term of office?

Dramatic fall in inflation; income tax rates lower and allowances higher at all levels; improved fiscal environment for business and industry; privatisation measures; measures to encourage competition, widen choice and extend property ownership; removal of wide range of Government regulation and restrictions; public spending brought under control; number of public service employees reduced and more efficient systems of management introduced. Changed attitudes about responsibilities and pay. Greatly improved efficiency in industry points to stronger base for sustained recovery.

5. Latest $\frac{1}{2}$ point cut in base rates: just a political gesture?

No; justified by overall assessment of monetary conditions. [For material on monetary developments/policy mortgage rate prospects etc see Section E; exchange rate policy see Section F.]

6. CBI critical of high interest rates/exchange rate?

[CBI Press Notice following monthly Council meeting 15 June when conducted post-Election review of full range of policies affecting business. CBI to see Chancellor Wednesday 22 June and PM Monday 27 June.]

CBI not critical: like Government, want to see interest rates brought down further. Also stress need not for lower exchange rate per se but less volatility. In line with Williamsburg sentiments (see F4).

7. When will the alleged secret manifesto be brought out and implemented?

There is no secret manifesto. The published manifesto sets out our intentions fully and frankly. Our actions will be consistent with these.

8. Fiscal policy and public spending in Government's second term?

See Sections H and K.

9. Select Committee on Procedure (Finance) Report: Government response?

[Report published 16 May makes number of major recommendations relating to Parliamentary control of borrowing, of non-'supply' expenditure and public expenditure as a whole, and of long term expenditure projects. Also major proposals for budgetary reform, and proposals relating to contingencies fund and to provision of financial information. Report would, if fully implemented, lead to major shift of power in financial area from Executive to Legislature.]

Committee have produced substantial piece of work with large number of recommendations across whole range of financial procedure affecting expenditure, taxation and borrowing. Government will want to consider them carefully. Detailed comment inappropriate at this stage.

Output and Demand

Increasing signs of continuing gradual recovery. GDP has recovered by 2½-3 per cent since spring 1981. Underlying industrial output in the three months to April was around 3-3½ per cent above its trough in the second quarter of 1981 (largely oil). Manufacturing production in three months to April rose by 1 per cent on the previous three (chemical and allied industries and electrical engineering showing strongest improvement). Car and steel production up 18 and 20 per cent respectively in 3 months to May on preceding 3. [BUT NOTE: recovery remains modest and patchy.]

Consumers' expenditure, on preliminary estimates was little changed in first quarter of 1983 but still 3 per cent up on year earlier. Retail sales rose by 1½ per cent in three months to May on preceding 3. In first 4 months of 1983 17 per cent more cars were registered than same period a year earlier. Import penetration of cars, at 56½ per cent, was down on 1982 average of 57½ per cent. Far less destocking in 1983 Q1 -only £42 million by manufacturers and distributors, compared with £900 million in second half of 1982.

Prospects

CBI's May Industrial Trends Enquiry seemed to confirm previous CBI reports (particularly the detailed April Quarterly Survey) in pointing to continued improvements in business climate. It showed encouraging improvements in total and export order books (former now stronger than in any enquiry since November 1974). Balance of firms expecting further increase in output was positive for fourth successive month. Balance of firms reporting excessive finished stocks lowest since November 1979. April Survey showed highest level of business optimism since 1976. DOI's May Investment Intentions Survey indicates a rise of 3-4 per cent in investment (manufacturing and distributions services) in both 1983 and 1984 [NB manufacturing investment expected to fall by 4 per cent between 1982 and 1983 but underlying trend expected to turn upwards later this year.]

Housing starts (total) in 3 months to April up 14 per cent on year earlier (though have fallen since February); private sector starts up 15 per cent on same comparison. New construction orders up 10 per cent in 1983 Q1 compared with year earlier; private housing orders up 46 per cent on same comparison.

Total engineering orders rose 3 per cent to February compared with previous 3 months and export orders up 25 per cent on same comparison. The CSO's cyclical indicators point to a continuing upswing in the business cycle. Recent outside forecasts suggest slightly higher growth (GDP) this year than our own Budget estimate of 2 per cent.

Financial Strategy

PSBR: government borrowing now amongst lowest in industrialised world. Public expenditure planning total in FSB for 1983-84 (at £119.3 billion) below total published in 1983 White Paper and about £ $\frac{1}{2}$ billion below planning total announced in Autumn Statement. First time since 1977 that a Government has not increased its spending plans in course of Survey. Fall in ratio between public expenditure and GDP from 44 $\frac{1}{2}$ per cent in 1981-82 to 44 per cent in 1982-83 (expected outturn) should fall again to 43 $\frac{1}{2}$ per cent in 1983-84 and 41 $\frac{1}{2}$ per cent in 1985-86. Short-term interest rates have fallen by about 7 points since autumn 1981. Official external foreign currency debt reduced from \$22 billion in May 1979 to less than \$12 billion at end-May 1983.

Inflation

RPI inflation over the 12 months to May was 3.7 per cent - the lowest figure since March 1968 and it appears we may now be doing a little better than expected. Inflation is forecast to remain moderate, stabilising around 6 per cent by end-1983. Underlying 12-monthly increase in average earnings was 7 $\frac{1}{4}$ per cent in April and continues steady fall since beginning of 1980/81 pay round.

Productivity and Competitiveness

Manufacturing output per head has risen about 17 per cent since end 1980. Output per head and output per hour now about 9 $\frac{1}{2}$ and 12 $\frac{1}{2}$ per cent higher than previous cyclical peak in 1H 1979. Manufacturers' unit wage and salary costs up around 2 $\frac{1}{2}$ per cent in 1983 Q1 on a year earlier. Compares very favourably with major competitors. Cost competitiveness (manufacturing) improved by around 20 per cent since early 1981 (based on sterling effective rate of 84).

Company Finances

Industrial and commercial companies' gross trading profits (net of stock appreciation, excluding North Sea) up 15 per cent in 1982 on average 1981 level. Real profitability also improving - pre-tax real rate of ICC's (excluding North Sea) estimated up from 3 $\frac{1}{2}$ per cent

In 1981 to 4 per cent in 1982 - but recovery from very low base. Latest DOI company liquidity survey showed encouraging improvement in liquidity between 1982 Q4 and 1983 Q1. Company liquidity at best level since mid-1979.

Labour Market

Underlying level of unemployment still rising but some evidence that rate of increase is slackening. Notified vacancies still appear on an upward trend (although fell slightly in May). CBI's April Survey pointed to some slowdown in rate of demanning in manufacturing over next few months. Further special employment measures announced in Budget, eg part time Job Release scheme, extension of Enterprise Allowance scheme; on full range of employment and training schemes Government is spending over £2 billion in 1983-84, directly helping about $\frac{3}{4}$ million people. Total number of working days lost in 1982 (5.3 million) well below average of 12 million for preceding 10 years. Latest international comparison of industrial disputes showed that, in 1981, UK occupied a middle ranking position compared with other countries.

Freedom, Enterprise and Initiative

Long list of controls abolished in last Parliament: pay, dividends, prices, exchange controls, office development permits, industrial development certificates and HP controls. Further 13 enterprise zones announced in 1982 bringing total to 24.

Civil service now 648,700 (1 April 1983) - reduction of $11\frac{1}{2}$ per cent since Government took office. On target to achieve smallest Civil Service since War by 1984 (630,000). LA manpower (GB) cut by 106,000 (approximately $4\frac{1}{2}$ per cent) between June 1979 and December 1982. Owner occupation at highest ever level: 56 per cent of all dwellings in 1981. Almost $\frac{1}{2}$ million public sector tenants bought their houses since May 1979; further $\frac{1}{4}$ million in process of buying. Quangos abolished or reduced expected to exceed 440 by April 1984. 36,000 Government forms abolished. MOD saved 5,000 staff and £10 million by contracting out cleaning. Up to and including 1982/83 special asset sales worth £2 billion; further £2 $\frac{1}{2}$ billion expected over next 3 years.

B ECONOMIC ACTIVITY AND PROSPECTS

[NB GDP (1983 Q1) figures to be published Tuesday 21 June.]

1. Recent output figures

[GDP (0) the best short-term indicator of the three GDP measures - rose $\frac{3}{4}$ per cent in 1983 Q1, confirming a clear upward trend since 1982 Q1; level now $2\frac{1}{2}$ -3 per cent above 1981 Q2 trough. Evidence of declining trend in manufacturing output during 1982 but this now seems to have been reversed. Industrial production in three months ending April was $1\frac{1}{2}$ per cent up on previous three; underlying industrial output now around $3-3\frac{1}{2}$ per cent above 1981 Q2 trough (largely due to oil and gas); manufacturing production 1 per cent higher in three months to April than in previous three.]

GDP has recovered $2\frac{1}{2}$ -3 per cent since spring of 1981, and industrial output has recovered around $3-3\frac{1}{2}$ per cent. Manufacturing production three months to April increased 1 per cent on previous three. Expectations (eg recent CBI Trends inquiries) are for further increases in manufacturing output, and recent forward indicators (eg recent CBI reports, CSO indices of leading indicators) point to continued gradual recovery both in manufacturing and more generally.

2. Domestic industry missing the consumer spending spree?

[For details of consumer spending see Commentary. Buoyancy, particularly of retail sales, contrasts sharply with movements in consumer goods production. In three months to April latter was only $\frac{1}{2}$ per cent up on preceding three months and was little changed from its level a year earlier.]

Consumer goods production figures disappointing. However, CBI's May Trends Enquiry suggested that higher output expected across much of manufacturing including consumer goods firms. Clearly there remains scope for further improving competitiveness by moderating wage settlements and improving product design, etc.

3. UK suffered worst of major industrialised countries since 1979?

[Between 1979 and 1982 latest estimates suggest output in Germany rose slightly, in US was broadly constant, in Canada fell by over 1 per cent. This compares with UK GDP (output measure) fall of about 4 per cent - though not strictly comparable measure.]

UK GDP grew relatively slowly throughout post-war period. True that UK entered recession earlier than competitors, but also emerging sooner. In 1982 our performance was better than most.

4. Prospects for UK economy

[March Industry Act Forecast published in FSBR summarised in Commentary.]

Total output forecast to grow significantly in 1983 (2 per cent) and to be growing slightly faster ($2\frac{1}{2}$ per cent) in 1984 H1, with inflation remaining moderate. Recent outside

forecasts in broad agreement on outlook for this year, with output growth expected to be, if anything, slightly higher than in Budget time forecast.

5. Where will growth come from?

Economy is now growing. Total output 2½-3 per cent above 1981 trough; underlying industrial output up 3-3½ per cent on same comparison; manufacturing production (particularly chemicals and allied industries and electrical engineering) has also begun to increase, though recovery remains modest and patchy. With inflation at lower level, and lower interest rates, conditions are favourable for further growth in demand and activity.

6. Latest (May) CBI Industrial Trends Enquiry

[See Commentary for details.]

Latest results seem to confirm previous CBI reports (in particular, the more detailed April Survey) in pointing to continued improvements in business climate and gradual economic recovery. However, as Sir James Cleminson has pointed out: 'The improvement is still uneven and is led by consumer and export demand'.

7. Latest ^Sconstruction industry indicators suggest recovery over?

[Construction output, on provisional estimates, fell 1 per cent between 1982 Q4 and 1983 Q1 (earlier estimates indicated 1½ per cent increase) but remains 4 per cent up on year earlier; new housing output rose 4 per cent in 1983 Q1 on preceding quarter. Total construction orders rose 6 per cent in 1983 Q1 on preceding quarter; private housing orders up 29 per cent on same comparison. Total housing starts up 7 per cent in three months to April on preceding three.]

Construction output - particularly housebuilding - recovered relatively rapidly last year - by almost 9 per cent in year to 1982 Q4. Given this performance, some pause not surprising though latest figures are disappointing. But not too much weight should be placed on one quarter's figures, particularly when forward indicators both for construction and output more generally remain encouraging.

8. Recent private investment performance?

[Manufacturing investment (including leasing) in 1983 Q1 over 4 per cent down on 1982 Q4 and over 5 per cent downⁿ latest six months compared previous six. But total capital expenditure by manufacturing, distribution and service industries up 1 per cent latest six months compared previous six.]

Manufacturing investment has been disappointing (over 4 per cent fall, including leased assets, in 1983 Q1) but accounts for only small proportion of total investment, and CBI latest DOI investment intentions Survey point to recovery later this year (see B9). Fixed investment in other sectors has been stronger: total fixed investment rose 3-4 per cent in 1982 and in 1983 Q1 investment in distributive and service industries (excluding shipping and leased assets) grew by almost 2 per cent on ^oprevious quarter. Housing starts and new

construction orders are encouraging, and April CBI survey showed improvement in manufacturing investment intentions: for first time since July 1979, majority of firms intended authorisations for plant and machinery investment to increase over next 12 months.

9. Investment intentions?

Latest DOI investment intentions survey indicates 4 per cent fall in manufacturing investment between 1982 and 1983 but also suggests underlying trend should start to turn upwards later this year. Outlook for distribution and service industries investment more encouraging. April CBI Survey also forecast modest recovery in manufacturing investment by end of this year and continuing into 1984.

10. Continued destocking threat to recovery?

[For latest statistics see Commentary. NB Whole economy stockbuilding figures for 1983 Q1 to be published Tuesday 21 June.]

Manufacturers' and distributors' destocking in 1983 Q1 was, as expected, much smaller than stock reductions in 1982 H2, and latest (May) CBI Enquiry shows further drop in net percentage balance of firms reporting excessive finished goods stocks - now at lowest level since November 1979.

11. Productivity growth falling off in manufacturing sector?

Slight drop in productivity growth last year. But output per head gains still impressive - up 5½ per cent in year to 1983 Q1; and overall improvement of around 17 per cent since end 1980. Some slowdown in 1982 against background of some fall in manufacturing output (after some recovery in 1981). But slowdown probably inevitable since best opportunities for plant closures and improved efficiency taken first. Overall performance since 1981 better than could have been expected on past experience.

12. CSO's indices of leading cyclical indicators

All four composite indices have risen over last few months. Taken together, indicators point to continuing upswing in business cycle.

13. Outside forecasts

[GDP profile in recent major assessments and in March IAF:]

	IAF	Cambridge Econometrics	Phillips & Drew	Simon & Coates	NIESR	CBI	Per cent change	
	(Mar)	(June)	(June)	(June)	(May)	(Mar)	LBS* (Feb)**	OECD* (Feb)
1983 on								
1982	+2	2½	+2½	+2½	+2½	+2	+1¾	+1½
1984 on								
1983	+2½***	2½	+2	1½	+1½	+2½	+2	+1¾***

* Taking no account of Budget measures

** More recent LBS projections pointed to GDP growth around 2-3 per cent in 1983, 2½-4 per cent in 1984, depending on assumptions about General Election outcome.

*** 1984 H1 on 1983 H1]

Nearly all major outside forecasts see prospect of continued modest recovery (GDP up around 2-2½ per cent in 1983) and modest price inflation around 6-7 per cent range by end 1983.

C LABOUR MARKET

[NB For latest information on earnings/pay settlements see Section D.]

1. Unemployment figures (new basis)/ other labour market indicators?

[May fall in 'headline' total largely reflects favourable seasonal factors and impact of new provisions for over 60s to get automatic credits. Vacancies are on a slowly rising trend (though fell slightly in May). Overtime worked broadly flat and still around 5 per cent down on 1982 average. Hours lost through short time working remain well below peak levels reached in early 1981.

	June	Sep	Dec	Mar	Apr*	May*
'Total unemployment' (millions)	2.77	3.07	3.10	3.17	3.17	3.05 (12.8%)
Adult sa unemployment (millions)	2.77	2.87	2.95	3.03	3.02	2.97 (12.4%)
Average change over 3 months to June, Sept etc (thousands)	+28	+31	+28	+26	+13 [+23]	-10 [+24]
Vacancies (000s)**	105	107	118	126	135	131

* From Apr 1983 unemployment figures reflect effects of automatic credits for men over 60 - figures in square brackets allow for these effects.

** Only about one third of vacancies are officially notified]

The unemployment figures continue to be affected by special factors. Large fall in headline total masks underlying upward trend. Although there are indications that this upward trend has eased, the improvement is modest. Other labour market indicators are mixed.

2. True level of UK unemployment really much higher than published figure?

Gross exaggerations are in circulation, relying heavily on assumptions, eg out-dated estimate of one million fall in labour force between 1979 and 1981, and including those benefiting from special employment measures - who are not unemployed. Latter 'adjustment' to official figures is clearly inappropriate; former is corroborated by most recent statistics. Between 1979 and 1981, small reduction in labour force due to lower 'activity rates' was insufficient to offset increases in population, and labour force grew by $\frac{1}{4}$ million.

3. But official figures take no account of unregistered unemployment/non-claimants?

Long been recognised that, for variety of reasons, some people seeking work do not appear in statistics of claimants. On other hand, recognised that some claimants not actively seeking work. Some estimates of number involved will appear in article to be published in June Department of Employment Gazette.

4. Employment/Social security measures in Budget just Government manipulating the figures?

[Changes announced in Budget: automatic credits for men aged 60-65 and higher scale supplementary benefit for man over 60, plus part-time JRS and enterprise allowance. First of these removed around 104,000 from May unemployment count; taken together, Budget measures will probably have 'register effect' of about 160,000 by March 1984, rising to about 180,000 by March 1985.]

No. Social security measures will help poorest section of unemployment over 60's and remove needless obligation. Part-time JRS will mean jobs for the unemployed because a part-time replacement must be recruited.

5. UK Government forecast of unemployment?

[Paragraph 3.39 of FSBR says: 'Growth of total output in the range 2-2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment.']

Government does not publish unemployment forecast. FSBR published with Budget says what might happen to unemployment over a period of years on certain assumptions, and under certain conditions. Whether it applies during the forecast period to mid-1984 depends on number of factors, including extent to which increase in wages and other costs moderate, and financial position of companies.

6. But didn't the new Chancellor forecast a fall in unemployment next year?

[Guardian 31 May: Mr Lawson said; '... in my judgement all the signs are that there is every prospect that by next year we will see the start of a fall in the level of unemployment'.]

Chancellor was simply pointing out that prospects were not nearly as bad as some were suggesting. As have said before, unemployment may turn out to be better than expected. There is always some degree of uncertainty about the future. Much will depend on factors outside Government's direct control - such as developments in the world economy and our ability to hold down domestic costs. And we should not forget good progress made over last year on inflation and output.

7. How has unemployment moved in relation to the 1983 PEWP assumption?

1983 PEWP assumed 2.74 million unemployment (GB excluding, school leavers) for 1982-83 and 3.02 million for 1983-84. These unemployment assumptions have not been changed from those given Government Actuary last November, except insofar as they have been revised onto the new (claimants) basis.

8. Could the outturn for unemployment be better than assumed in Cmnd 8789?

Yes. This is made clear in Cmnd 8789 which says (para 9 of Part I, and page 65 of Part II): 'The unemployment level in the later years may turn out to be lower than has been

conventionally assumed if developments in the world economy are favourable and if developments at home - notably by way of continued reduction in pay settlements - permit.'

9. Unemployment in UK compared with other countries

[On standardised definitions in April 1983 UK unemployment on new basis was 13.7 per cent (compared with 5.5 per cent in 1979), Canada 12.4 per cent (compared 7.4 per cent), US 10.0 per cent (compared 5.7 per cent), Japan 2.5 per cent (compared 2.1 per cent), France 8.0 per cent (compared 5.9 per cent), Germany 7.6 per cent (compared 3.2 per cent).]

Unemployment has risen sharply in many industrialised countries - increase over year to latest available month in number unemployed (on national definitions - not strictly comparable) was greater in Germany (39.8 per cent - rise of 2.2 points in unemployment rate - in May), and Canada (28.4 per cent - 2.6 points in April) than in UK (8.4 per cent - 1.0 points - in May).

10. Government's special employment measures

On full range of employment and training schemes Government planning to spend over £2 billion in 1983-84, bringing direct help to $\frac{1}{2}$ million people. Includes £950 million allocated to Youth Training Scheme and £260 million (gross) to (a) new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) new Job Splitting Subsidy to encourage extension of part time work. From 1 October Job Release Scheme will include new scheme for part-time job release for up to 40,000 more people and from 1 August Enterprise Allowances will be available throughout UK within overall cash limit of £25 million in 1983-84.

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

Probably true in short run. But as experience in Japan and many other countries clearly demonstrates, higher productivity essential for longer term growth and employment opportunities.

12. Cost of unemployment/Effect on PSBR?

Changes in unemployment affect public finances according to underlying circumstances, eg changes in world trade, UK competitiveness, relative UK earnings etc. Not sensible to talk as if 'cost of unemployment' a single figure. Unemployment and supplementary benefit to people counted as unemployed currently expected to total about £5.7 billion in 1983-84 (DHSS estimate in 1983 PEWP) comparable figures for uncollected taxes and national insurance contributions cannot be given.

13. Total cost of unemployment £ 15/16/17 billion?

This is a figure without meaning. There can be no basis for estimating what public finances would look like if all the unemployed were working.

D PRICES AND EARNINGS

PRICES

1. Inflation rate

[12 monthly RPI increase 3.7 per cent in May, compared 4.0 per cent in April].

12 monthly rate of inflation again fell sharply in May to 3.7 per cent - lowest level for over 15 years (compared 3.4 per cent in March 1968).

2. Inflation increasing in second half of year

RPI scarcely rose at all between June and September last year. As a matter of simple arithmetic there is likely to be an increase in the 12 month change over corresponding period in 1983. It was made clear at Budget time that after months of faster than expected progress, inflation was expected to be about 4 per cent in May with some slight rise later in the year perhaps to about 6 per cent; if anything progress since then has been better than expected.

3. Effect of lower exchange rate?

Budget forecast took into account, among other factors, depreciation of £ since the autumn. Since then fall has been partly reversed. But exchange rate only one factor amongst many that affect inflation. Offsetting factors include weak commodity prices (including oil), low increases in UK labour costs (rise in earnings slowed down further, productivity gains continuing, and cuts in NIS); likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies.

4. Inflation in future years

Budget forecast of RPI inflation only extends to 1984 Q2. Beyond that policies will continue to be directed towards further progress in reducing inflation. Underlying trend has been downward since 1980.

5. TPI increase

12 monthly increase in TPI (3.2 per cent) over year to May 1983, now $\frac{1}{2}$ per cent lower than for RPI (3.7 per cent) because of Budget increase in tax allowances.

6. Comparison with competitors

[April figures UK inflation 4.0 per cent compared 3.3 per cent in West Germany, 3.9 per cent (annual change on new index) in US, 9.2 per cent in France, 16.5 per cent in Italy, 6.6 per cent in Canada, and 2.0 per cent in Japan; 4.8 per cent weighted average 'major 6'.]

UK inflation now lower than average of major OECD 6 and well below France, Italy and Canada, but still some way to go to match West Germany and Japan.

PAY

7. Current level of settlements

CBI data bank of manufacturing settlements shows average lower than last year at 5.8 per cent in pay round so far and 5.6 per cent so far in 1983 . Latest average earnings index (April) shows 8.2 per cent increase (underlying increase $7\frac{1}{2}$ per cent) on year earlier; but this is still influenced by settlements in the last round, and also includes effect of 'drift' as well as settlements.

8. Pay settlements too high?

[Year on year growth average earnings 8.2 per cent in April, compared 4.0 per cent growth in RPI.]

Pay settlements have continued to come down in last couple of years, which is sign of greater realism. But inflation has come down more, and earnings over past year have risen much faster than prices. Improved employment prospects depend on lower earnings growth, and that means lower pay settlements.

9. Recommendations of Review Bodies

Government published on 12 May its decisions on Reports from the Armed Forces Pay Review Body and from the Doctors' and Dentists Review Body. The recommendations have been accepted. Two reports from the Top Salaries Review Body on the salaries of the higher civil service, senior officers in the Armed Forces and the judiciary, and on salaries of MPs and Ministers and other office holders, and Parliamentary allowances, were deferred for consideration after the Election.

E MONETARY AND FINANCIAL POLICY

1. What is Government's monetary policy in its second term?

Government continues to adhere to 1983 MTFS. Growth of M1, £M3 and PSL2 within last year's target range of 8-12 per cent. Target is 7-11 per cent for 1983-84.

2. Is the money supply out of control?

[M1, £M3 and PSL2 grew by 1.5 per cent, 0.8 per cent, and 0.8 per cent respectively in banking May (seasonally adjusted). Annualised growth rates of first 3 months of current target period produces rates of growth well above target range.]

No. Signs of moderation last month. First two months of target period affected by surge of public sector borrowing. Annualising of rates of growth highly misleading when using only a few months figures. Target range is for a year as a whole, not particular months.

3. Is there a change in emphasis away from the money supply towards the exchange rate?

No. Government looks at whole range of factors in assessing financial conditions. This includes the exchange rate.

4. Does recent fall in base rates despite high monetary growth indicate a change in policy?

No. We look at a variety of indications of financial conditions. The evidence from real interest rates, inflation and the exchange rate is that monetary conditions remain sound.

5. Any prospect of a further fall in interest rates?

Sound monetary conditions and low inflation offer best basis for sustainable reductions in interest rates. Interest rate reductions are desirable, but only if not jeopardising this strategy.

6. Would higher US interest rates mean reversal of recent falls in UK interest rates?

Not really.

7. Did Government engineer interest rate fall to stop Building Society rates rising?

[Building Society Association meet 22 June.]

Building Societies decide their rates on the basis of their needs. The reduction in base rates was associated with the Bank's lower dealing rates on 13 and 14 June. There were other important developments in the money markets, notably the marked fall in interbank rates the preceding week.

8. Bank lending

[Rise of £0.9 billion in banking May after £0.2 billion in April and £0.6 billion in March banking months.]

Continues at levels well below levels reached last summer. Recent slackening continues.

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Compared last October, sterling has fallen 9 per cent in effective terms, 10 per cent against the dollar, 9 per cent against the D-Mark, 21 per cent against the yen. On 24 March, sterling touched 6-year low of 77.9 in effective terms and on 28 March reached record low against dollar of \$1.4515. Sterling subsequently recovered with return of greater confidence about stability in oil markets. In the run up to the General Election the £ strengthened, but has now fallen back to its effective levels in early May.

	October average	17 June noon	% change Oct - 17 June
\$/£	1.6977	1.5295	-9.9
DM/£	4.2932	3.8889	-9.4
Y/£	460.12	365.09	-20.7
£ effective	92.5	84.0	-9.2

2. Exchange rate policy

Government has no target for exchange rate and considers that recent events suggest that in current conditions pursuit of a target would not be viable policy. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible.

3. Government wants lower exchange rate?

[Report in The Times 11 June said officials advised new Chancellor to cut interest rates to prevent further rise in pound.]

Government's approach to exchange rate is symmetrical whether pound is rising or falling. It is one, but only one, of factors taken into account in interpreting domestic monetary conditions, in Government's attitude to interest rate movements. Similarly, market intervention has been provided in both directions in recent months, but intervention cannot hope to prevent movement in face of strong market pressures - or, by itself, influence the rate in other than the short term. [See E3 on interest rate-exchange rate policy.]

4. Williamsburg Summit 28-30 May

[See also T1-2]

Summit partners resolved to improve consultation, policy convergence and international co-operation to help stabilise exchange markets, bearing in mind their conclusions on the Jurgensen report (see F6).

5. Jurgensen Report - significance?

[Jurgensen report on exchange market intervention, commissioned at Versailles Summit, published 29 April.]

Report covers only narrow topic of intervention. It aims at giving better understanding of the methods, motives and effects of past intervention. Therefore did not make any policy recommendations. Does not herald an early return to fixed exchange rates. Although it notes importance of broader economic policies in determining the exchange rate it did not consider wider issues of greater policy convergence or IMF surveillance. These questions were considered at Williamsburg and will be taken further in IMF.

6. Jurgensen Report - verdict on UK policy?

Report's findings confirm approach taken by UK Government. Government have always felt that intervention could be useful at times to help steady and calm disturbed market conditions. But always considered that consistent pursuit of sound, counter-inflationary monetary and fiscal policies is only long-term solution to problem of exchange rate instability, and that trying to solve problem through intervention alone would be misguided and ineffective.

7. Improve UK competitiveness directly by engineering further fall in exchange rate?

As previous Chancellor said in Budget Speech, devaluation brought about by monetary and fiscal laxity would be damaging - and to seek it as deliberate act of policy - as some of Opposition propose - would be great mistake. Would be signal to world of willingness to accommodate rising inflation, an inflation that would undoubtedly be fuelled by demands for higher wages to offset the effects. Confidence would collapse and jobs would be destroyed. CBI at last Monthly Council meeting made no mention of devaluation but stressed need for less volatility.

8. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Thus for example West Germany's cost competitiveness deteriorated 20 per cent between 1970 and 1980 but she maintained her 20 per cent of main manufacturing countries' exports. Japan managed to increase her share over this period from 12 to over 15 per cent despite slight deterioration in cost competitiveness. UK industry equally capable of non-cost improvements - witness, for example, Jaguar cars: their drive for higher quality secured them an increase in overseas sales in 1982 of 56 per cent over previous year.

9. Situation has been made less stable by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All our experience is that exchange controls have little effect in the face of strong market movements. They did not control leads and lags in trade payments, nor the movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations.)

10. Join EMS exchange rate mechanism (ERM)?

Government considers that recent events scarcely suggest that conditions that have led successive Governments to delay sterling's full membership of the ERM are yet right for us to join. Sterling as a major internationally traded currency is still being affected by oil and other factors in a different way from the D mark. Membership of the ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

11. Impact on inflation of fall in sterling before April?

See D3.

12. Level of overseas debt

Total official external foreign currency debt now stands at just under \$12 billion, compared with \$22 billion when Government took office. Remaining debt now smaller in relation to imports than at any time since Second World War.

G BALANCE OF PAYMENTS AND TRADE POLICY

BALANCE OF PAYMENTS

[NB Overseas trade and balance of payments on current account in May to be published Friday 24 June]

1. Balance of payments so far this year?

1983 Q1 balance of payments figures showed current account surplus of £445 million after £4 billion surplus last year. Invisibles surplus in Q1 was £0.7 billion.

2. April trade figures

[Current account in deficit in April £180 million; current account in three months to April £400 million in surplus].

Trade figures erratic month to month. Underlying level of non-oil imports now seems to be increasing as activity picks up.

3. Trade in manufactures in deficit?

[Trade in manufactures was in deficit £664 million in first quarter - on balance of payments basis. In 1982 trade in manufactures was £2½ billion in surplus.]

Exports of manufactures have held up well. Higher manufactured imports one way in which we have benefited from N Sea oil.

4. Export trends

Underlying level of non-oil exports has probably not changed significantly over recent years, despite world recession. Latest CBI quarterly Industrial Trends Survey shows sharp improvement in order books and expectations of rise in deliveries over next few months.

5. Import trends

Having shown little change during 1982, imports have risen in 1983. Largest increases in imports of basics and semi-manufactures.

6. Invisibles

Deterioration on invisibles in 1982 for private sector largely on interest, profits and dividends, which - at a surplus of £1.1 billion - were down £0.6 billion on 1981.

7. Current account 1983 forecasts

FSBR forecasts £1½ billion current account surplus in 1983 (down from £4 billion in 1982). Import volumes 1983 on 1982 expected to increase 5 per cent - reflecting resumption of

growth in UK economy. Export volumes not expected increase significantly until world economy starts to pick up, with only 1 per cent growth in exports forecast for 1983 on 1982 .

TRADE POLICY

8. Protectionism

Government has been concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Has been pressing for positive European Community action to remedy this. But will be continuing to defend the open trading system. [Buying British: see P5.] Leaders at Williamsburg summit committed themselves to 'halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers' They emphasised importance of working through GATT.

9. What can UK do to safeguard our producers against dumping of subsidised imports?

UK has right to take selective action where British producers subjected to unfair competition. Under international agreements, EC and GATT can counter by imposing specific duties with aim of getting countries responsible to abandon such practices.

10. Japan

Japan recently agreed Community-wide export restraints in number of sensitive product areas, including tariff cuts and improvements to non-tariff barriers to trade. A helpful review of standard procedures has also been completed. These developments welcome, but we shall continue to press for measures to increase the level of our exports to Japan and for a more equal trading relationship.



H FISCAL POLICY AND THE PSBR

1. Does Government plan to tighten/weaken fiscal policy?

Policy evolves but commitment to overall strategy is unchanged.

2. Progress on fiscal policy?

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

Have made progress. PSBR has been reduced (but see H3 and 7). Continuity, firmness and stability of policies have made major contribution to reducing inflation and interest rates.

3. Government's financial strategy has replaced monetary targets with PSBR target?

No. Have always emphasised need for consistent fiscal and monetary policies.

4. PSBR/interest rates link discredited?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - lower PSBR over run of years implies lower interest rates - still holds true.

5. Why did 1982-83 PSBR overshoot?

[Budget estimate £7.5 billion, provisional outturn £9.0 billion. CG own account borrowing higher by £1 billion, LABR by £0.5 billion, PCBR by £0.1 billion.]

Mainly higher than expected supply expenditure (£0.9 billion) and higher local authority borrowing (£0.5 billion). End year surge of expenditure greater than expected at time of Budget. Even so, still within £9.5 billion forecast in 1982 Budget. Downward path in ratio PSBR/GDP has been maintained. [GDP ratios in 1980-81 $5\frac{1}{4}$ per cent, 1981-82 $3\frac{1}{2}$ per cent, 1982-83 $3\frac{1}{4}$ per cent. MTFS ratio for 1983-84 is $2\frac{1}{4}$ per cent.]

6. Public expenditure ~~out~~ of control?

No. Simply less underspending on plans than was assumed at Budget time. No question of any failure of public expenditure control system. Only two extremely minor breaches of cash limits and year ended with large part of the Contingency Reserve unspent.

7. PSBR overshooting this year - tax increases or expenditure cuts in the offing?

[Budget forecast £8.2 billion, 2½ per cent. As result of last year's overshoot and high figures for CGBR recently, many - but not all - outside forecasters now predict an overshoot.]

Too early to form new view about prospect for this year. Next official forecast will be published with next Autumn Statement. Government intend to continue firm control of public spending and borrowing.

8. But high CGBR in April and May surely means PSBR overshooting?

[CGBR in April to May £2.9 billion compared with £1.9 billion in 1982-83.]

Too early to say. Budget forecast is £8.2 billion - next forecast at time of Autumn Statement.

9. Doesn't PSBR overshoot mean higher interest rates?

Yes, a lower PSBR probably would have meant lower interest rates. But effect of overshoot limited because it does not signal a change of strategy. PSBR over a run of years is what really counts.

10. Government misleading public over PSBR outlook?

No. Must remember PSBR difference between two large aggregates and always difficult to assess likely end-year borrowing. FGBR contained strong 'health warnings', so can hardly be accused of misleading people.

11. PSBR uncertainty exposes inadequacy of Government's strategy?

No. Strategy not based on fine-tuning the PSBR. PSBR is not a target.

12. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test is level of interest rates at which PSBR can be financed, not value at some hypothetical cyclically adjusted level of output.

13. UK fiscal policy tightest in world?

[IMF report said UK fiscal contraction over last 3 years was largest of any major country; OECD calls for prudent fiscal relaxation.]

Agree we have had more success in controlling borrowing than many other countries. They are now trying to emulate us. IMF and OECD support our commitment to cutting inflation and interest rates.



TAXATION

1. Government's tax objectives?

Manifesto said that further improvements in allowances and lower rates of income tax remain a high priority, together with measures to reduce the poverty and unemployment 'traps' (see also J13). Manifesto also referred to encouraging wider ownership, through lower taxes on capital and savings, encouraging individuals to invest directly in company shares and encouraging the creation of more employee share schemes.

2. Early Finance Bill?

Before Dissolution, Government stated its intention to introduce early Bill to restore original Budget proposals on higher rate thresholds, investment income surcharge threshold, increase in ceiling for mortgage interest relief to £30,000, CTT thresholds and bands and profits limits for small companies rate (38 per cent) of corporation tax. The other matters to be included in the Bill will be announced in due course.

3. Government's tax record?

Over period 1979-83 Government cut basic and higher rates of income tax, achieved a 6 per cent real increase in allowances, cut NIS from 3½ per cent to 1 per cent, reformed CGT, CTT and DLT regimes, greatly improved the tax arrangements for profit sharing and share option schemes, introduced new reliefs for investment in unquoted companies (Business Expansion Scheme), improved incentives for charitable giving and cut tax bureaucracy. Not a bad start.

4. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39½ per cent in 1983-84. Corresponding figures excluding NIC are 28½ per cent and 32½ per cent].

Burden inevitably risen because of upward pressures on public expenditure caused by recession and need for responsible fiscal and monetary policies. Budget provided significant cut in income tax burden by increasing personal allowances by 14 per cent - 8½ percentage points over inflation. Those in work whose earnings have risen in line with national average have higher real take-home pay now than in 1978-79.

5. Government's own figures prove average family now pays more tax than in 1978-79?

Necessary to measure changes in the tax burden in a way which avoids distortion because of the switch from child tax allowances to child benefit. A couple where the man is on average earnings and there are 2 children will pay a smaller proportion of their earnings in income tax net of child benefit in 1983-84 than they did in 1978-79.

6. Budget benefits for lower paid

Budget provided help for lowest paid by removing 1½ million people from tax in 1983-84, compared with position if allowances had remained unchanged. Low paid therefore among greatest gainers from increase in thresholds in real terms for second successive year. Low paid with children will also benefit from 11 per cent increase in Child Benefit to highest real level since its introduction, and from generous increases in FIS.

7. Tax reductions in Budget wiped out by increases in national insurance contributions?

[NICs rise in April by 0.25 per cent of earnings for the contracted in, and 0.6 per cent for contracted out.]

Tax reductions will be greater than effect of increase in NICs for all but a minority. [BACKGROUND: Those who will lose are contracted out with about 1½ times average earnings and a very small number of contracted in.]

8. Effect on people with mortgages of MIRAS and recovery of excess tax relief?

Tax payments will go up as result of MIRAS but mortgage payments will go down. Borrowers entitled to ask building society to reduce their monthly payments in such a way that their net position is unchanged. When mortgage interest rates fell last year, PAYE codes were not altered and people received more relief than they were entitled to. Recovery of this excess relief, which increases tax payments, allows people to pay tax that should have been paid last year by easy instalments. In no sense an increase in tax burden.

9. Average worker with mortgage only 19p a week better off after Budget?

[Calculation for particular type of individual in Answer to Sheldon PQ as follows: £2.02 income tax cut, minus 40p NIC increase, minus £1.43 recovery of excess mortgage tax relief.]

Wrong to treat repayment of tax underpaid last year as a tax increase. Annex to Mr Sheldon's PQ also showed this individual over £6 a week better off than last August, as result of cut in income tax in last Budget and fall last year in mortgage interest rates.

10. Some people not getting mortgage interest relief as a result of switch to MIRAS?

No one entitled to the relief will be deprived of it. A number of people with bank mortgages have not been brought into the new scheme. A few of these have also lost the relief through their tax coding. Anyone in that position should contact their tax office, who will put matter right as quickly as possible.

11. What did Budget do for industry?

Budget contained substantial help for industry, worth about £½ billion in a full year, on top of £½ billion benefit to industry of changes announced in Autumn Statement. Included

further NIS cut. Number of measures in Budget precisely targeted to help particular sectors. For example, Business Expansion Scheme builds on highly successful Business Start up Scheme for small firms. Reintroduction of Small Engineering Firms Investment Scheme will be of benefit to engineering, particularly in places, such as West Midlands, most hit by recession.

12. NIS reduction

Further $\frac{1}{2}$ per cent cut in NIS will benefit private industry by nearly £400 million in full year. Rate of NIS has been reduced by $2\frac{1}{2}$ percentage points since April 1982 - worth nearly £2 billion to private sector in full year. Government's intention is to abolish the surcharge when this can be responsibly afforded: substantial cost (£1.2 billion in a full year) cannot be disregarded.

13. What action is planned to reduce poverty and unemployment traps?

[Draft Meacher committee report, not approved by full TCSC, published on 16 June.]

The Committee has produced a long, detailed and generally thorough draft report, which recognises that the traps have grown up over many years, are not unique to the UK and are not amenable to easy solutions. The Manifesto (see J1) accorded high priority to the traps, and the Government will be examining the draft report with care. Long-term solution to traps is best achieved by maintaining public expenditure restraint, thus allowing tax thresholds to be increased (as in Budget), and by sustained improvement in economic performance leading to higher real earnings.

14. Future of married man's personal allowance?

Government's 1980 Green Paper on Taxation of Husband and Wife set out number of different options; these being considered in light of very wide range of views received. Abolition, by itself, would affect many millions of taxpayers and leave a basic rate taxpayer nearly £6 a week worse off.

15. Keith Committee Report on Enforcement Powers of Revenue Departments

First part of report published 23 March. Second part should be ready later this year. Very substantial document deserves careful study and full consultation; inevitably lengthy process. Some aspects controversial: all the more need for careful consideration and consultation. Report draws attention to scale of 'black economy' - Government is concerned about tax evasion; numbers of investigation staff in Revenue Departments have been increased.

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE PLANS

1. Following the Election, how firm are Government's expenditure plans for future years as published in February 1983 White Paper and revised in the Budget?

Existing PEWP plans as revised by Budget are starting points for next public expenditure survey, now imminent. Government stated during Election campaign that intend to stick to published expenditure plans for next three years.

2. Capital spending plans lower in 1983-84 than 1982-83?

Immediate problem not making more funds available but getting local authorities and nationalised industries to spend capital provision available to them. Reduction in planned expenditure compared with last year's plans reflects fact that those plans were not realised.

3. Over-run on spending plans for 1982-83 suggests failure of public spending control

No. (See H6).

4. Implications for 1983-84 and later years?

[1983-84 planning total allows for net shortfall of £1.2 billion, or 1 per cent of total. Total shortfall for 1982-83 compared plans announced in 1982 Budget thought at Budget time likely to be £2.2 billion but now likely to be much smaller.]

Not clear that expenditure was accelerating in any underlying sense in last weeks of 1982-83. There are one or two items of expenditure that could have fallen either side of 31 March, but in the event fell inside 1982-83. Wrong therefore to draw conclusions either about likelihood of expenditure overshooting in 1983-84 or about appropriateness of figures for public expenditure shortfall and Contingency Reserve published with Budget.

5. Can public expenditure spending be prevented from rising sharply in future years?

Government's spending plans covering next three years show steady decline in ratio of public spending to GDP. Government has said that will keep firm control on future levels of public spending.

6. Policy on contracting out

Government encouraging further use of private sector contractors by public bodies where this will increase economy, efficiency and effectiveness, eg intention is to allow Government Departments to reclaim VAT on contracted out services thus removing a disincentive to contracting out.



LOCAL GOVERNMENT

7. Local authority overspending?

Local authority current expenditure in England some £ $\frac{3}{4}$ billion in excess of guidance issued by the Environment Secretary. (About half of overspending due to GLC and ILEA. All of the eighteen highest overspenders in Labour control). Overspending approximately £1 billion in GB overall. Local authorities were warned at the time of the last Rate Support Grant (RSG) settlement that such overspending would lead to holdback of grant. Details will be announced shortly.

8. RSG settlements 1984-85?

Government recognises that authorities need long notice of broad features of settlement; accordingly early announcements of grant quanta and planning totals are intended.

9. LA capital underspending in 1982-83

Latest estimates suggest that local authorities underspent their capital cash limits by a little over £1 billion in 1982-83, following underspending of £ $\frac{3}{4}$ billion in 1981-82. Steps were taken last autumn to reduce the underspend: PM wrote to local authority associations; local authorities invited to apply for extra allocations (well over £ $\frac{1}{4}$ billion issued), and allowed to spend without limit on improvement grants. Extra £150 million made available to Housing Corporation.

10. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83. Steps taken to reduce further underspending: new rules on receipts (measures announced on Budget Day by Environment Secretary to ease transitional problems including supplementary allocations), LAs can spend above allocations on improvement grants and eligible expenditure limits raised in Budget by 20 percent, also new 'enveloping' provisions (where whole streets being renovated) announced in Budget.

11. Revenue implications of capital projects

Concern about revenue implications should not inhibit full use of allocations: plans for relevant LA current expenditure allow for financing costs of full planned capital programmes; many capital projects have no immediate running costs eg roads, reclamation of derelict land; others will reduce running costs by rationalisation. Government cannot guarantee there will be no underspending - LAs take the decisions. But Government will be monitoring closely, and will take further action, if needed, to encourage full use of provision.

12. Reform of local government structure?

GLC and Metropolitan County Councils have proved to be extravagant and unnecessary tier of local government. Manifesto pledged abolition. Environment Secretary will shortly announce details of timing of legislation and consultation.

13. Legislation to limit rates?

Average level of rate increases could be moderated significantly if minority of overspending Labour-controlled councils followed Government guidance. Legislation will be introduced to give powers selectively to limit rate increases where budgets are excessive, and also to impose if necessary general rate limits. Details will be announced in due course.

14. Green Paper on Domestic Rating System

Government has been carefully considering representations. Need scheme that will remedy shortcomings of present rating system and command widespread support. Taking account of pleas from industry, business, etc.

FALKLANDS EXPENDITURE

15. What has defending Falklands cost so far and foreseeable future cost?

Costs of operation, of replacing equipment lost during conflict, and of garrison, were about £730 million in 1982-83. Provision has been made for £624 million in 1983-84, £684 million in 1984-85 and £552 million in 1985-86 (total some £2.6 billion).

16. Costs of repairing damage and reconstructing the Islands' economy

Too soon to say. Work has begun on restoration of essential services. About £10 million now expected to be spent in 1982-83; further £5 million in 1983-84. Ministers have agreed on package of measures for long term development of the Islands, tentatively estimated to cost in all £31 million over next 6 years.

17. Cost of paying compensation for war damage

Too soon to say. Expected that bulk of claims for civilian compensation will be settled in 1982-83, and remainder in 1983-84, but no accurate figure as claims still being processed. Total expected to be in region of £3½-4 million.

PAC REPORT

[PAC Report including item on non-competitive contracts for MOD published 19 May, another referring to non-competitive contracts for drugs on 26 May.]

L CIVIL SERVICE MANPOWER AND PAY

1. Size of civil service

Since May 1929, Civil Service has been reduced by 11½ per cent to 648,700 (at 1 April 1983). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target 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. Privatisation?

Civil Service Unions say that Government services and establishments are being 'privatised' to meet arbitrary manpower targets, and that more than a third of fall in Civil Service numbers by 1984 will be accounted for by privatisation or 'hiving-off'. In fact, privatisation and hiving off will only account for about 12 to 15 per cent of total manpower savings. Departments have been asked to look at scope for further privatisation and contracting out. (See also K6.)

3. Civil service efficiency?

Civil Service unions say drive for efficiency, motivated largely by Government's determination to reduce size of civil service, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. 630,000 target not arbitrary: Departmental targets have been adjusted according to needs. Great savings already made with little effect on provision of services. No conflict between central manpower control and Financial Management Initiative (see 6 below).

4. Manpower policy after 1984

Survey of manpower needs being collated centrally. Manpower planning now on same basis as expenditure planning. Departments exploring option cuts of 5 per cent and 10 per cent and stating needs for extra staff. No decisions have been taken.

5. Management and Personnel Office

MPO now part of Cabinet Office. Lord Gowrie, Privy Council Minister of State and Arts Minister responsible for day to day issues, Mr Barney Hayhoe, Treasury Minister of State, answers in the Commons. Prime Minister, as before, in charge.

6. Government measures to improve standard of financial management in civil service

In May 1982 launched financial management initiative aimed at promoting in each Department an organisational system in which managers at all levels have clear view of

their objectives, and means to assess performance against them; well-defined responsibility for making best use of their resources; and the information, training and access to expert advice to exercise responsibilities effectively. Departments were required to submit programmes of work to Treasury and MPO by January 1983; these have been assessed by Treasury and MPO officials. Departments now moving into first stage of implementing action. Government is committed to publish a central report on the initiative by July 1983.

7. Civil service pay negotiations for 1983 - non-industrials

Council of Civil Service Unions representing the non-industrial civil service have signified their acceptance of the agreement reached with Treasury. The agreement will increase pay, London Weighting and pay related allowances by 4.86 per cent on average. The cost is to be met from within the provision already made for Civil Service administrative expenditure.

8. Claim for industrial civil servants

Claim for industrial grades has been received and acknowledged. [It seeks: (i) "substantial" increase in basic rates; (ii) restructuring of pay bands; (iii) increases in the special efficiency productivity bonus, and consolidation of other productivity bonuses into basic pay; and (iv) other improvements in hours, leave etc.] First meeting of the JCC pay sub-committee to discuss the claim held on 21 April. Pay offer deferred until after General Election.

9. Civil Service pay in 1984-85?

[Press speculation about a possible civil service pay cash limit.]

No decision has been taken on the provision for pay in central government cash limits for 1984-85.

10. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Discussions now in progress.

11. Top Salaries Review Body and the higher civil service

See D10.

M SOCIAL SECURITY

1. Government intentions for next uprating?

[Under Social Security and Housing Benefits Act, passed at end of last Parliament, will revert to 'historic' method of uprating. Uprating still made in November, but no longer based on inflation forecast, but on actual inflation in year to May, now known to be 3.7 per cent.]

Under legislation passed at end of last Parliament, uprating no longer based on inflation forecast - which proved inaccurate 5 times out of 7 - but on actual inflation in year to May (now known to be 3.7 per cent). Social Services Secretary will put detailed proposals to Parliament in very near future. Public Services pensions, under current legislation, will be uprated in line with state retirement pension.

2. Historic RPI fails to price-protect pensions?

[Opposition will argue that inflation in year to November forecast at 6 per cent at Budget time - although signs we are doing slightly better than that - while uprating likely to be only 3.7 per cent].

No. Beneficiaries retain 2.7 per cent real increase in pensions at November 1982 upratings. In last Parliament, Government made clear that had old forecast method been used there would have been adjustment to reflect this. Full adjustment would have implied 6-2.7 = 3.3 per cent uprating. Most 'unpledged' benefits were increased by more than rate of inflation: some, such as Family Income Supplement, Mobility Allowance, were increased substantially in real terms.

3. 'Unpledged' benefits?

[Manifesto renewed pledge given period of last Parliament to 'continue to protect retirement pensions and other linked long term benefits against rising prices'. Pledge does not cover other benefits, most importantly supplementary allowance, unemployment benefit, housing benefit, child benefit].

Manifesto renewed pledge, which we more than fulfilled over last Parliament, to protect pensions and linked long term benefits against inflation. This covers benefit expenditure of nearly £20 billion. Imprudent in present circumstances to promise more. But in last Parliament most 'unpledged' benefits were increased by more than rate of inflation: some, such as Family Income Supplement, Mobility Allowance, were increased substantially in real terms.

4. Budget improvements in social security?

[Chancellor announced:

- (a) 11 per cent increase in child benefit to £6.50 in November;
- (b) restoration of 5 per cent abatement of unemployment benefit;

- (c) 'invalidity trap' being abolished (inability of invalidity pensioners to qualify for long term rate of supplementary benefit); pensioners under 60 will get long term rate after one year; those over 60 immediately. Helps 55,000 sick and disabled people;
- (d) higher scale (long term) rate of supplementary benefit to be available to unemployed men over 60 on supplementary benefit effective from June (in addition, men between 60 and 65 no longer need to 'sign on' in order to safeguard pension entitlement);
- (e) therapeutic earnings limit (amount disabled and chronic sick can earn - with doctor's approval - before benefit withdrawn) up from £20 to £22.50; and
- (f) new mobility supplement for war pensioners (broadly equivalent civilian mobility allowance but with £2.10 war pensioners preference premium).]
- (g) main supplementary benefit capital disregard up from £25000 to £30000; single payment disregard up from £300 to £500; new separate disregard of £15000 for life assurance policies.

Various improvements to help on top of basic uprating.

N EUROPEAN COMMUNITY

1. UK refunds for 1983

Stuttgart European Council agreed to basic net refund of £450 million in respect of 1983. This produces average refund rate over four years 1980-83 of nearly 66 per cent. Appropriate figures will be entered in 1984 draft budget.

2. Deal is conditional, surely this is bad?

Nothing conditional about 1983 agreement. The sums will be entered in and paid from 1984 budget.

3. Longer-term budget negotiations

European Council agreed that they would reach conclusions in December on Community's future financing, including ways of limiting expenditure on CAP, accommodating enlargement, and solving problems of budgetary imbalance. Commission will prepare proposals in these areas. UK will negotiate on them in constructive spirit.

4. UK objectives on EC budget for longer-term?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

5. Will UK agree to new 'own resources'?

We have agreed that review of the EC's future financing should consider inter alia question of extent and timing of EC's requirements for resources. This does not prejudice the outcome. HMG remains unconvinced of need for new 'own resources'.

6. Reforms in Common Agricultural Policy?

European Council invited Council of Ministers to consider number of reforms to operation of CAP designed to reduce its cost. UK will be in forefront of those arguing for implementation of measures to achieve effective control of agricultural expenditure and observance of strict guideline on its rate of growth. Key measures remain price restraint and curbs on surplus production.

7. UK Government response to Commission request for advance to meet cash crisis?

Commission has right to invite these advances. We have agreed that, in view of current ~~cost~~ ^{cash} position, an advance should be made in June.

8. UK budget settlement for 1982

UK's basic refund is £631 million gross (about £500 million net). Supplementary and special energy measures covering this refund were announced on 28 March. 90 per cent of total was paid over by 30 March, and balance will come later in year. Further refund entitlements under the risk-sharing arrangements will be determined later this year.

9. Policy for CAP reform

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

10. Costs of CAP to UK consumers

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

11. European Monetary System exchange rate mechanism

See F7.

P INDUSTRY

[CBI views on policies affecting industry - see A6.]

1. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

2. Company Sector

(i) Company liquidity ratios

[D. Industry's survey of 200 large companies shows continued trends to improved liquidity between 1982 Q4 and 1983 Q1. Total current assets rose by over £2 billion; current liabilities fell by about £1 billion. For manufacturing companies in the survey, current liquidity ratios rose from 79 per cent to 104 per cent - highest figures since 1979 Q2.]

Latest D Industry figures show continued encouraging improvement in liquidity, particularly for manufacturing, between 1982 Q4 and 1983 Q1. Although liquidity ratio for manufacturing companies still low, it has improved very considerably since 1980. No widespread concern about liquidity.

(ii) Company profits/rate of return

[Gross trading profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding oil, rose almost 15 per cent between 1981 and 1982; but increase was from a very low base. ICC's real pre-tax rate of return (excluding North Sea) estimated up from 3½ per cent in 1981 to 4 per cent in 1982. No 1982 estimate for manufacturing available, but 1981 figure of 2 per cent was half previous cyclical low figure in 1975.]

1982 seems to have seen some welcome improvement in ICC's rates of return. But the recovery was from a very low base. Further progress depends on better performance by companies. Government can best help by getting inflation down and setting sound basis for sustained recovery. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

3. Company insolvencies

[Total bankruptcies in 1982: 5,700 - up 11 per cent on 1981. Provisional figure of liquidations in 1982: 12,000 - up 40 per cent on 1981.]

Figures to some extent reflect disappointing output performance in 1982. Need to remember that new company formation is also substantial. High company liquidations and large number of new companies formed partly a symptom of structural change.

4. Government help for small firms

Measures enacted in shortened Finance Act provided further measures to help enterprise and small businesses, increasing the number of measures taken so far from which small firms can benefit to over 100. Enterprise and small firms package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); introduced new Business Expansion Scheme to replace Business Start-Up Scheme. These measures designed to encourage start-ups and existing firms. In total, measures to assist enterprise and small firms introduced since 1979 have full year revenue cost of around £500 million.

5. Buying British

Many British products have always been competitive. New competitive ones coming onto market. When buying British must take account of price and quality - otherwise would only render firms incapable of competing effectively internationally. But should give British products - and ourselves - a full and fair chance.

6. Loan Guarantee Scheme?

[Nearly 9,400 guarantees already issued - about half to new businesses. Total lending under scheme over £310 million. 1982 Budget provided for lending ceiling in first year (to May 1982) to be raised to £150 million and for further £150 million to be available in second year (to May 1983). 1983 Budget raised ceiling by £300 million (to £600 million) for third year (to May 1984). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. By end-January 1983, payments under scheme in respect of 'called' guarantees exceeded premium income plus recoveries by £3.8 million.

7. New Enterprise Zones

Proposed sites for nine new zones in England were announced by Environment Secretary 15 November though one of these (NE Derbyshire) is not now going ahead; sites for two new zones for Scotland, one for Northern Ireland and two for Wales have also been announced. Meanwhile, the report from consultants published 26 April shows that the zones in general appear to be succeeding in their primary purpose of bringing new life and investment to some very run-down areas.

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. Approach to improving Nationalised Industries' performance?

Reform of nationalised industries is central to economic recovery. Best way to improve performance in long term is to expose the industries to market forces, through reduction of monopoly, and through privatisation. Meanwhile, tight financial framework ensures that disciplines commonplace in private sector are also imposed on State industries. Challenging performance aims are being set and top class managers have been appointed. Rolling programme of Monopolies and Mergers Commission investigations set up in previous Parliament will continue.

2. EFLs for 1982-83 and 1983-84?

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. Actual outturn now expected to be about £1.8 billion. British Telecom and British Gas undershot EFLs substantially. EFLs for 1983-84 currently total £2.5 billion.

INVESTMENT

3. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Not Government policy to provide funds for public sector projects with lower returns than those in private sector. Pre-tax rate of return on nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

4. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of nationalised industries investment. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in both 1981-82 and 1982-83. Even so, latest estimates suggest that actual investment in 1982-83 increased by 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PAY AND PRICES

5. Nationalised industries' prices

[Increase in NI prices water charges and London Transport fares over 12 months to April 1983 7.5 per cent, compared RPI increase of 4.0 per cent.]

NI prices expected to rise at slightly lower rate than RPI in 1983-84. This substantial improvement is sustainable only so long as the industries contain their current costs (particularly pay) in the way that private sector companies have to do.

6. UK industrial energy prices above those of European counterparts?

CBI's recent report on comparative energy prices confirms that vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating electricity.

7. Prospects for gas and electricity prices in 1983?

Freeze on industrial gas prices extended to first nine months of this year. Domestic gas prices expected to rise by no more than rate of inflation. On average, industrial and domestic electricity prices will not be increased at all in 1983. These decisions taken by the industries themselves purely on commercial grounds.

PRIVATISATION

8. Why privatise?

Privatisation key element in economic strategy which will be pursued with renewed vigour in this Parliament. It opens up new areas to disciplines of market forces, promotes competition and efficiency, and improves the quality of service to consumers. Already substantial record of achievement; British Aerospace, Cable and Wireless, National Freight Consortium, Amersham International, Britoil, Associated British Ports, International Aeradio, some British Rail subsidiaries and certain NEB holdings, including Ferranti and Faireys, have been transferred to private sector. So far, privatisation programme has brought in receipts of over £2 billion.

9. Future privatisations?

Wytch Farm oil field sale to be completed this year. British Telecom, Rolls Royce, British Airways, BGC's offshore oil interests, substantial parts of British Steel, of British Shipbuilders and of British Leyland, and as many as possible of Britain's airports, will

become private sector companies. We will prepare for introduction of private finance into Royal Ordnance Factories. We will continue to identify and prepare other potential candidates for privatisation. We aim to introduce substantial private control into the National Bus Company and increase competition in, and attract private capital into, the gas and electricity industries.

10. Special asset sales in 1982-83?

Estimated outturn for 1982-83 around £500 million. Full details of receipts will be published shortly.

11. What sales included in special asset sale targets for future years?

[PEWP 1983 has targets of £750 million (previously published target £600 million) in 1983-84, £1500 million (previously £600 million) in 1984-85 and £500 million in 1985-86, for proceeds from special sales of assets.]

Not practice to disclose details of composition of targets because timing of sales dependent on market conditions and price information commercially sensitive.

S NORTH SEA AND UK ECONOMY

1. Will OPEC agreement hold? BNOC prices?

Whether OPEC's agreement works will depend on OPEC. Price negotiations matter for BNOC's judgment. But North Sea prices will obviously be related to prices of closely-competing crudes. BNOC will continue to monitor market developments, and act accordingly.

2. Impact of lower oil prices on UK?

Large disruptive movements in any direction are in no one's interest. But modest and gradual fall we have seen should reduce inflation and boost growth - both in UK and rest of world. Trade balance effect relatively modest. Budget forecast assumed oil prices would remain on average at about current levels. If oil prices were to fall further, Chancellor remains ready to take appropriate action. Position would need to be reviewed in light of circumstances at the time.

3. Latest published projections of North Sea revenues

[FSBR/MTFS projections of Government revenues from the North Sea (in money of the day): £7.8 billion in 1982-83; £8 billion in 1983-84 and 1984-85; £9½ billion in 1985-86. Higher than last year's FSBR and Autumn Statement projections, partly because of higher production in tax-paying fields, partly higher sterling oil prices. Other forecasters generally predict higher revenues.]

Oil revenue projections depend on uncertain cost, price and production assumptions. Prospects for North Sea revenues in 1983-84 better than in 1982 FSBR and Autumn Statement because of higher than previously assumed sterling oil prices and production in tax-paying fields. Latest projections generally consistent with recent BNOC announcement on North Sea prices. In general, higher forecasts by others based on combination of higher future production and prices and lower expected future capital expenditure.

4. Fall in North Sea output after 1985? Effect on revenues?

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline. Cannot be complacent about impact on economy of falling North Sea output. Effect of falling output on revenues will be muted because of tendency of revenues to lag behind output.

5. What remains of Budget proposals on oil taxation?

Phasing out of Advanced Petroleum Revenue Tax, doubling of oil allowance, and immediate Petroleum Revenue Tax relief for exploration and appraisal drilling were all included in the truncated Finance Act. Bill to abolish royalties on future fields will be reintroduced as soon as possible.

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

Without North Sea revenue taxes would be higher or public expenditure lower. 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. Will thus provide income for day when oil runs out. But keep revenues in perspective. Estimated at about 6 per cent of total General Government receipts in 1983-84.

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

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.

8. Revenues from oil being frittered away on consumptions/unemployment benefits?

No. We are using the oil revenues to reduce the PSBR and interest rates, leaving more room for the private sector to borrow and invest: an essential step towards creating a strong and growing economy.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Williamsburg Summit 28-30 May

Summit partners sounded note of optimism reflecting confidence in prospects for recovery. They noted success in reducing inflation and interest rates, and agreed on need for prudent, balanced policies to ensure spread of recovery to all countries. Summit governments pledged themselves to pursue monetary and fiscal policies conducive to lower inflation and interest rates, more investment and greater employment. Also agreed to take forward the multilateral surveillance process initiated at (1982) Versailles Summit.

2. New 'Bretton Woods'?

[President Mitterand and Mr Muldoon, among others, have been reported recently as calling for new international conference to examine monetary problems.]

Summit partners invited Ministers of Finance, in consultation with Managing Director of IMF to define conditions for improving international monetary system and to consider part which might, in due course, be played in this process by a high level international monetary conference.

3. World recovery under way?

[Encouraging signs of recovery particularly in US and Canada where industrial production rose sharply in first quarter and housing starts have risen. In Europe, industrial production also rose slightly in first quarter, and business confidence has improved. According to Press Reports OECD Secretariat has revised up forecast for growth in industrialised countries this year to 2 per cent (from 1½ per cent December 1982 forecast).]

Welcome signs of recovery particularly in those countries which have successfully reduced inflation (notably US, Germany and UK). The recovery is likely to accelerate during the course of this year and into early next year, with output rising by perhaps 1½ per cent in 1983.

4. Latest inflation figures

[Consumer price inflation down from a year ago in all major economies apart from Italy on latest available figures: US (from 6.6 to 3.9 per cent), UK (9.5 to 3.7 per cent), Japan (2.8 to 2.0 per cent), Canada (11.3 to 6.6 per cent) France (13.9 to 9.1 per cent), Germany (5.0 to 3.3 per cent), Italy risen slightly (from 15.2 to 16.4 per cent).]

UK performance in bringing down inflation in past year as good as any, and better than most of our major trading partners. Falls in inflation have helped lay basis for signs of recovery being seen both in UK and rest of world this year.

5. Prospects for US economy?

[Industrial production has risen for past 6 months, retail sales have begun to improve, and GNP rose by about ½ per cent in first quarter although this mainly due to slower destocking.]

Welcome further signs that recovery underway in US although too early to be sure recovery firmly established.

6. US Budget

[Senate passed budget resolution for 1984 in May providing for tax increases of £9 billion and 6 per cent rise in real defence spending contributing to budget deficit of \$179 billion. House of Representatives proposed lower deficit of \$175 billion partly due to higher tax increases of \$30 billion and lower defence spending. House and Senate will now meet in conference to try to reach compromise. Neither of proposals acceptable to President Reagan who has threatened to veto any major tax increases.]

Share widely expressed concern over potential size of budget deficit. Important that firm measures to reduce deficit be agreed if US interest rates are not to rise again, as economy recovers.

7. US has relaxed monetary policy?

[M1 has grown very rapidly in recent weeks following slight fall in April and is well above its 4-7 per cent target range set out in February. M2 and M3 are within their target range.]

Federal Reserve following firm but flexible policies in face of distortions affecting monetary aggregates, Fed is keen to sustain recovery but remains solidly committed to preventing any resurgence of inflation.

8. What about a fresh allocation of Special Drawing Rights? Why not allocate SDRs exclusively to LDC's?

IMF will be examining desirability of further SDR allocation, in light of current trends in growth, inflation, and international liquidity. We have an open mind about case for further allocation. The Fund's Articles require SDR allocations to be issued to all member pro rata with their quota.

9. International Debt

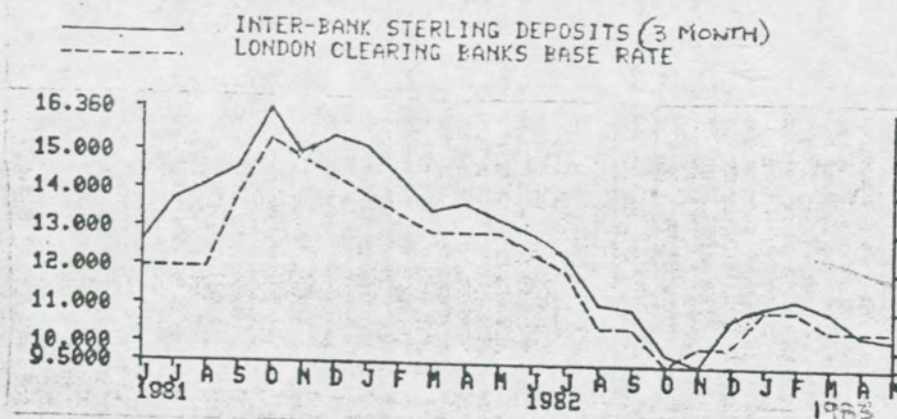
[Many developing countries have faced considerable financing difficulties due to falls in commodity prices, high interest rates and strength of dollar.]

Glad to see many of largest debtors now undertaking adjustment programmes, often with IMF assistance. Although some short term financing difficulties may remain, (eg Brazil), falls in interest rates last summer, recent rises in commodity prices and expected growth in underlying conditions have improved due to world trade during this year.

Financial Conditions

1. The monetary aggregates M1, £M3 and PSL2, all grew within the 8-12 per cent target range for 1982-83. The relatively large rises in the aggregates in April and May mainly reflected the high level of Government borrowing at the turn of the financial year. Real monetary growth has risen steadily this year. Real interest rates remain relatively high (and perhaps somewhat higher than last autumn) and other indicators, such as falling inflation, do not suggest lax monetary conditions.

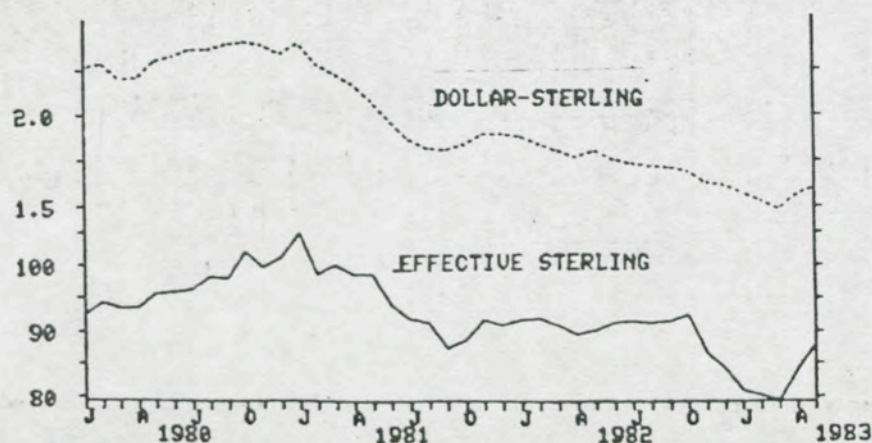
INTEREST RATES



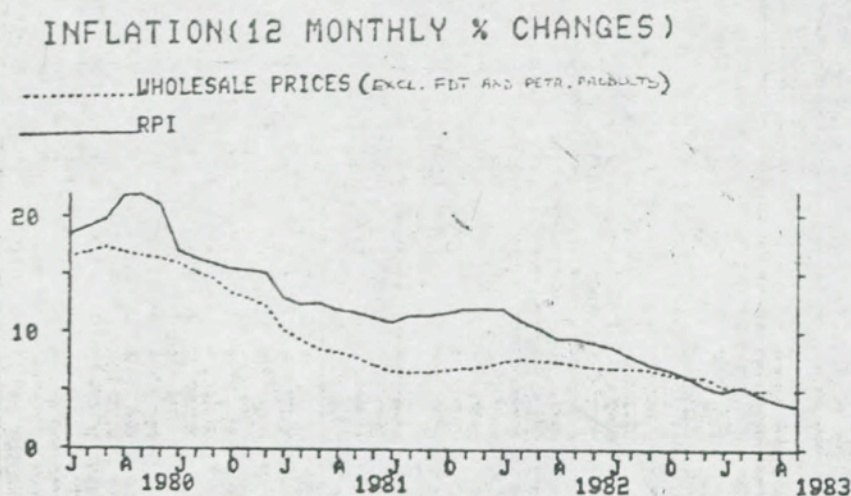
2. The PSBR is estimated at £9.2 billion in 1982-83. This represents $3\frac{1}{2}$ per cent of GDP which is slightly lower than the comparable figure for 1981-82 ($3\frac{1}{2}$ per cent) but somewhat higher than the estimate published with the 1983 Budget ($2\frac{1}{2}$ per cent of GDP), mainly reflecting less than expected underspending by central government. Public sector borrowing as a percentage of GDP has been on a downward trend and is only around a third of its level in the mid-1970s.

3. The effective exchange rate is now around 85 (1975 = 100), somewhat lower than the 90-91 range occupied for most of the period summer 1981-autumn 1982.

EXCHANGE RATES



4. Inflation continues to fall. The 12-monthly increase in retail prices was 3.7 per cent in May, its lowest level for over fifteen years. Other measures of inflation tend to show somewhat larger increases (the RPI has been benefitting from exceptionally low increases in food prices and the cuts in mortgage interest rates), though still a declining trend.



5. Average settlements in manufacturing are currently running at about 5-6 per cent, some 1½ per cent lower than in the 1981-82 pay round, but still significantly above the level of price inflation. The underlying 12-monthly increase in average earnings was 7½ per cent in April and continues the steady fall since the beginning of the 1980/81 pay round.

6. In the first four months of 1983 average earnings grew around 3 per cent faster than both the RPI and the TPI suggesting large improvements in both gross and net real earnings. On a longer term comparison the growth in real take-home pay has been more modest as has the movement in per capita real personal disposable income (which includes the net income of those out of work as well as those in work).

REAL INCOME GROWTH

Year-on-year % changes

	Per Capital RPDI	Net Real Earnings (using the TPI)
1980	+1.1	+2.8
1981	-1.8	-1.6
1982	-1.1	-0.4
1983 Q1	na	+3.3
1983 April	na	+4.5

7. Much of the recovery in total domestic demand during 1982 reflected the growth in consumer spending, itself partly reflecting lower inflation and the summer 1982 abolition of HP controls. The slight fall in real personal disposable income in 1982 was offset by a fall in the savings ratio. Although consumers' expenditure appears to have changed little in 1983 Q1 it is still somewhat higher than a year ago. And retail trade remains buoyant.

CONSUMER SPENDING (VOLUME)

Year-on-year % changes

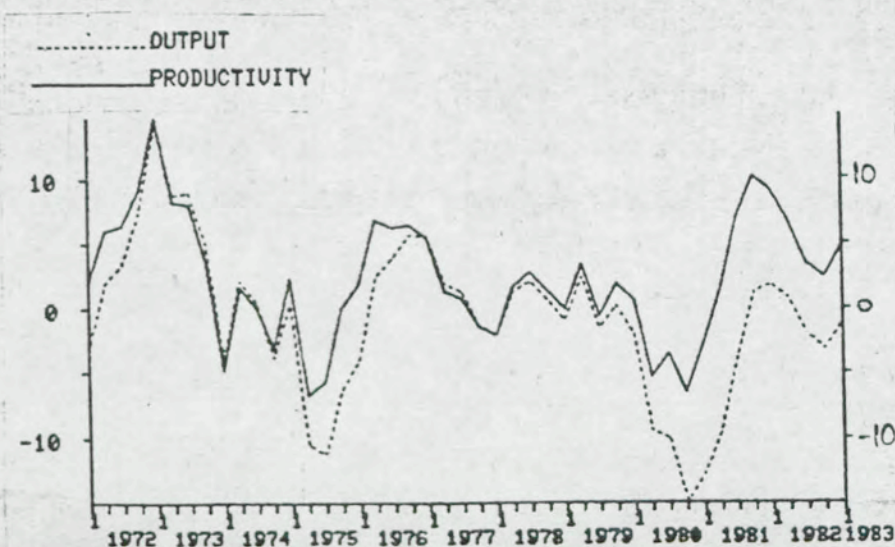
		Consumers' Expenditure	Retail Sales
1982	H1	0.0	0.9
	H2	2.2	4.2
1983	Q1	3.4*	4.3
3 months to May		na	5½*

* provisional/preliminary

Costs, Company Finances and Investment

8. Manufacturing output per head was up by 5½ per cent in the year to 1983 Q1, and some 17 per cent above its trough level at the end of 1980 - an impressive improvement for this stage of the economic cycle. Continued productivity gains, coupled with further wage moderation, have brought down the increase in manufacturers' unit wage and salary costs to around 2½ per cent in the year to 1983 Q1. This compares favourably with our major competitors. The increase would be lower still if a broader labour costs measure were used which incorporated the cuts in the National Insurance Surcharge. Industrial (non-oil) commodity prices (in SDR's) have risen strongly since the autumn according to the Economist index, but world oil prices have weakened and, after allowing for the lower exchange rate, prices of materials and fuels purchased by manufacturers are only some 3 per cent higher than in the autumn.

MANUFACTURING PRODUCTIVITY(4 QTR % CHANGES)



9. Nominal profits of industrial and commercial companies improved during 1982 - both for oil and non-oil firms - though from an historically low level and after a period of real declines because of inflation. This improvement is reflected in small increases in pre-tax real rates of return (the movement of real interest rates is discussed in the first paragraph) and in a strengthening of the company sector's financial position.

REAL NET PRE-TAX RATES OF RETURN

	Non-North Sea ICC's	Manufacturing
1960-70 (average)	11	10
1980	4	3½
1981	3½	2
1982	4	na

The latest DOI Survey of Company Liquidity showed a marked improvement in 1983 Q1 in the liquidity of the 200 large companies covered. It is now at its best level since the middle of 1979 and the greatest improvement was in manufacturing.

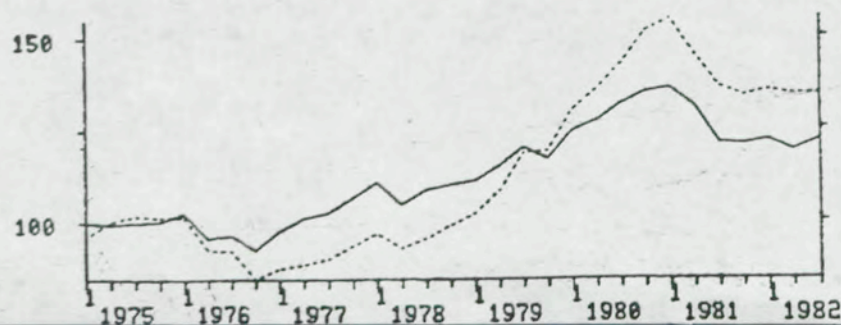
10. Total fixed investment has been broadly flat since mid-1982, with increases in distribution and services roughly offsetting a continued fall in manufacturing. Substantial destocking resumed in the second half of 1982 - partly because distributors initially responded to the upturn in consumers' spending by running down stocks. Far less destocking occurred in the first quarter of this year - only some £42 million by manufacturers and distributors, compared with £900 million in the second half of 1982.

Competitiveness and Trade

11. Manufacturing trade competitiveness can be measured in a number of ways although the commonly used indices concentrate on "cost" or "price" rather than "non-price" factors. Cost competitiveness (on the basis of an effective exchange rate of 84) is estimated to have improved by some 20 per cent since early 1981 (partly reflecting the lower exchange rate, partly lower pay settlements and higher productivity) though remaining substantially worse than in the mid-1970s.

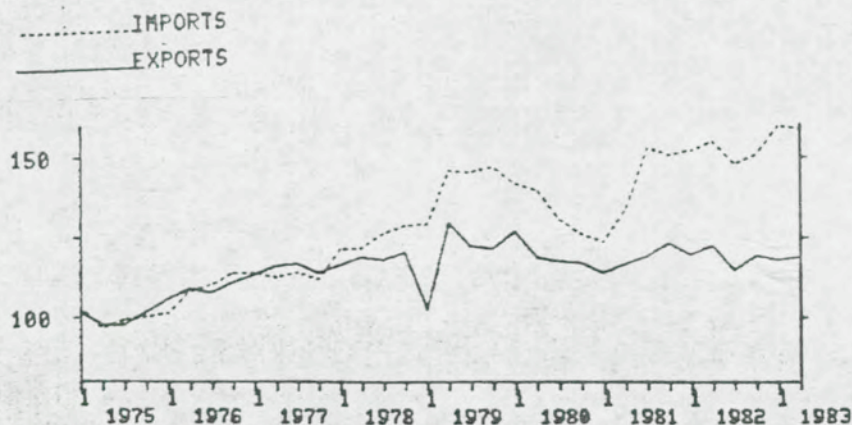
MEASURES OF MANUFACTURING TRADE COMPETITIVENESS

..... RELATIVE ACTUAL UNIT LABOUR COSTS
 ——— RELATIVE EXPORT PRICES



12. The current account of the balance of payments, though weakening, remained in small surplus in the first few months of 1983. Export volumes have continued to hold up well in relation to earlier substantial losses in competitiveness and weak world demand (though recently export strength has been coming from food and basic materials rather than manufactures). Import volumes were broadly flat in 1982 though, as expected, some rise has recently taken place associated with the slowdown in destocking and the recovery in domestic activity.

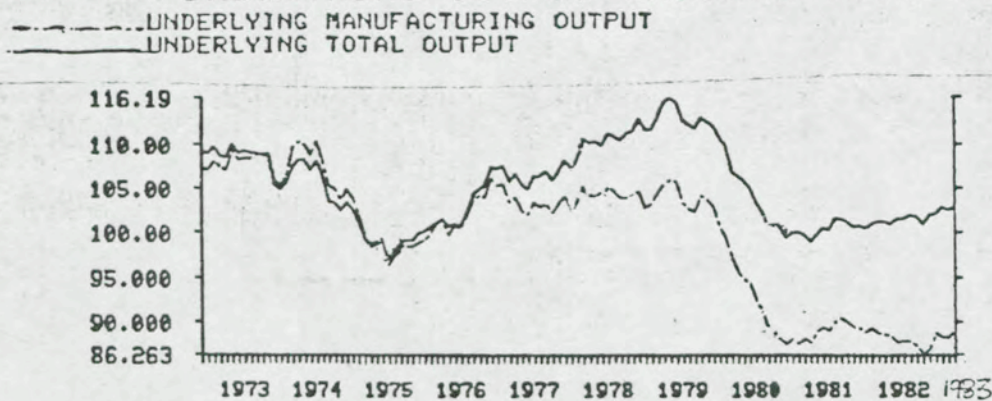
TRADE VOLUMES (EXCL. OIL & ERRATICS)



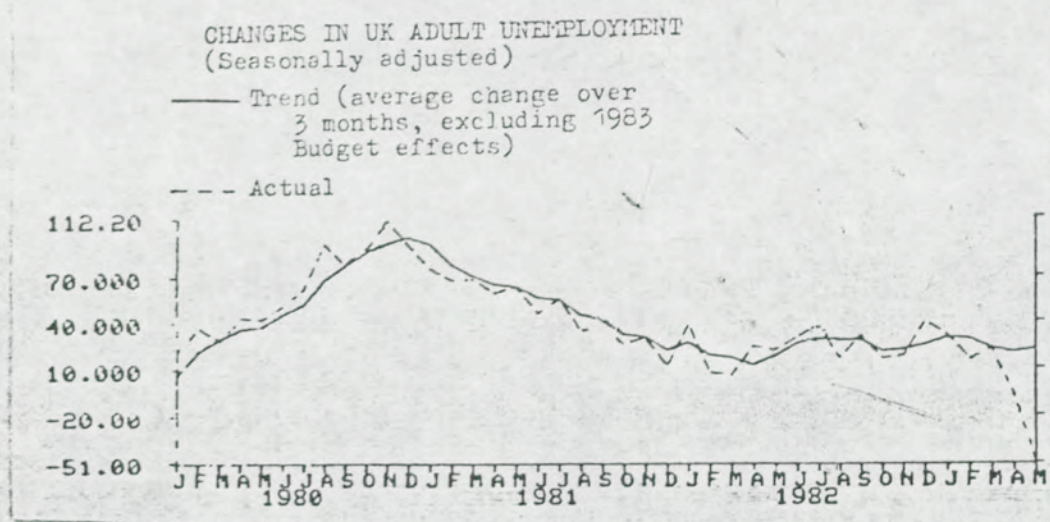
Demand, Output and Unemployment

13. In 1982 real domestic demand - using the expenditure components of GDP - was 2½ per cent higher than a year earlier. And partial information for the first quarter of this year suggests further growth largely resulting from the turnround in stockbuilding (full figures to be published on 21 June). There is also growing evidence that a modest recovery in domestic supply is underway. Total output (GDP) rose by ¼ per cent between 1982 Q4 and 1983 Q1 and is now 2½-3 per cent above its trough (reached in 1981 Q2). The underlying level of industrial output is some 3½ per cent above its spring 1981 trough, with about half this growth due to increased North Sea activity. Manufacturing output, which was on a declining trend during 1982, now also appears to be recovering.

INDUSTRIAL OUTPUT INDICES (1975=100)



14. However, the underlying level of unemployment is still rising. In May, the UK total (not seasonally adjusted) was 3.05 million (12.8 per cent). Adult unemployment (seasonally adjusted) was 2.97 million (12.4 per cent). These figures were substantially lower than those for April but this reflects the effects of the Budget provision of automatic national insurance credits for men over 60. Allowing for the latter, the adult total rose by 23,000, a slightly smaller rise than in March and April. Notified vacancies fell by 3,000 in May to 131,000 but their trend still appears to be upward. The trend in manufacturing employment continues downwards but the CBI's April Quarterly Trends Survey points to some slowdown in the rate of demanning in the near future.



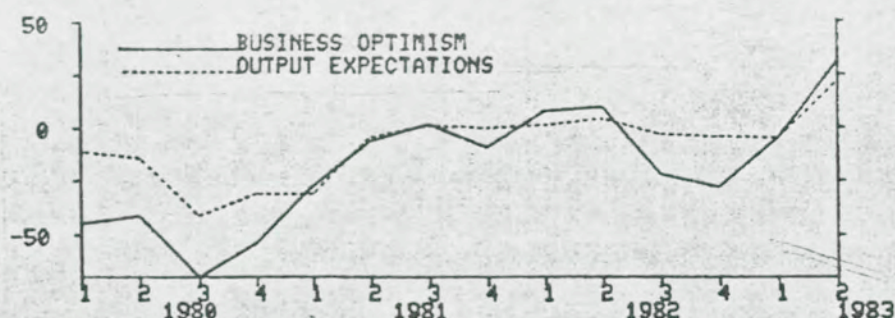
Recent forward indicators

15. The CSO's indices of cyclical indicators, taken together, point to a continued upswing in the business cycle. Other specific indicators show some generally encouraging signs. In the three months to May car production increased by 18 per cent compared to the previous three months. On the same comparison steel production was 20 per cent higher but remained 4½ per cent below the rate of production achieved in the same period a year earlier. Total engineering orders rose 3 per cent in the three months to February compared with the previous three months, and export orders rose by about 25 per cent on the same comparison. The volume of new construction orders continues to be quite buoyant as do total housing completions. Total housing starts have fallen since February but in the three months to April were 7 per cent higher than in the previous three months.

16. The CBI's April Industrial Trends Survey contained encouraging signs with improved business optimism (the highest net balance since 1976), order books and output expectations, and investment intentions. The results also pointed to a slowdown in destocking and job

shedding. This message was further confirmed in their May Enquiry which showed encouraging improvements in total and export order books (former now stronger than in any Survey since November 1979). The net balance of firms expecting an increase in output was positive for the fourth successive month and recently these balances have been the highest recorded since June 1979. The proportion of firms expecting an increase in average domestic selling prices is still higher than towards the end of 1982 but remains low by historical standards while the net balance of firms reporting excessive finished stocks is now at its lowest level since November 1979. The DOI's investment intentions survey (May) suggests a 4 per cent fall in manufacturing investment between 1982 and 1983 although the underlying trend is expected to turn upwards later this year. Other components of investment (distribution and services) are more encouraging and overall the survey indicates a rise of 3-4 per cent in investment in both 1983 and 1984.

CBI SURVEY INDICATORS(% BALANCES)



17. The Government forecast published with the Budget expects inflation to stabilise around the 6 per cent level by the end of 1983 (recent evidence suggests that progress on inflation has been better than expected). GDP is expected to rise by 2 per cent between 1982 and 1983 with a similar increase in manufacturing output. All demand components are expected to increase in 1983 with total domestic demand up by 3½ per cent. The current account surplus is anticipated to fall to £1½ billion in 1983 and the PSBR is expected to be £8 billion in 1983-84 (compared with £9½ billion in 1982-83). World trade is expected to rise by 1 per cent this year but to grow more strongly in the first half of 1984. Recent outside forecasts expect slightly higher GDP growth of around 2-2½ per cent in 1983 with some recovery in the world economy and inflation around 6-7 per cent by the end of the year. Consumers' spending and stockbuilding are the main expansionary influences but overall the expected improvement in activity is insufficient to prevent further expected increases in unemployment. For 1984 the outlook is less clear but all groups expect continued GDP growth though possibly at a slower rate than in 1983.

Key indicators to be published in week ending 24 June

Mon	20	: Cyclical Indicators (May)
Tues	21	: GDP (1st quarter)
Wed	22	: Construction - new orders (Apr)
Thurs	23	: New Vehicle Registration (May)
Fri	24	: Overseas Trade and BoP current account (May)